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INTELLECTUAL PROPERTY ANTITRUST PROTECTION ACT OF 1987

HEARING

BEFORE THE

SUBCOMMITTEE ON TECHNOLOGY AND THE LAW

OF THE

COMMITTEE ON THE JUDICIARY

UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

FIRST SESSION

ON

S. 438

A BILL TO MODIFY THE APPLICATION OF THE ANTITRUST LAWS TO
ENCOURAGE THE LICENSING AND OTHER USE OF CERTAIN INTEL-
LECTUAL PROPERTY

OCTOBER 20, 1987

Serial No. J-100-39

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INTELLECTUAL PROPERTY ANTITRUST PROTECTION ACT OF 1987

TUESDAY, OCTOBER 20, 1987

U.S. SENATE, SUBCOMMITTEE ON TECHNOLOGY AND THE
LAW AND SUBCOMMITTEE ON ANTITRUST, MONOPOLIES
AND BUSINESS RIGHTS, COMMITTEE ON THE JUDICIARY,
Washington, DC.

The joint subcommittees convened, pursuant to notice, at 9:37 a.m., in room SD-226, Dirksen Senate Office Building, Hon. Patrick J. Leahy (chairman, Subcommittee on Technology and the Law) presiding.

Also present: Senators Thurmond, Metzenbaum, DeConcini, and Specter.

Staff present: Ann Harkins, chief counsel, Subcommittee on Technology and the Law; Milo Cividanes, counsel, Subcommittee on Technology and the Law; and Priscilla Budeiri, counsel, Subcommittee on Antitrust, Monopolies and Business Rights.

OPENING STATEMENT OF HON. PATRICK J. LEAHY, A U.S. SENATOR FROM THE STATE OF VERMONT

Senator LEAHY. The Subcommittee on Technology and the Law and the Subcommittee on Antitrust, Monopolies and Business Rights will come to order.

We are having this joint hearing, and there will be other Senators who will come in periodically, on the Intellectual Property Antitrust Protection Act.

I might say in opening that the creative spirit of America's innovators has made our Nation the world's leader in high technology, and certainly those of my generation would like to see it stay that way.

America's economic future rests on the shoulders of individual inventors and innovators working in small firms and large corporations. We need to encourage continued innovation in high technology and to help American inventors and businesses recoup their tremendous investment in research and development.

Several of my colleagues on the Technology and Antitrust Subcommittees have joined me in introducing S. 438, the Intellectual Property Antitrust Protection Act, to do just that. This legislation will help America's businesses meet the challenges they face in domestic and international markets.

Our intellectual property and antitrust laws should operate together to encourage innovation by rewarding individual inventors and creators, and to promote competition by ensuring that those

inventors and creators have access to open and competitive markets.

Nonetheless, it is almost common for business people and scholars to say that our antitrust and intellectual property laws are in conflict. They say this because the misguided notion that our intellectual property laws grant economic monopolies has led to unnecessarily harsh treatment of patents and copyrights in antitrust cases.

As a result, American business may be forced to avoid agreements that would permit them to cut costs by developing efficient distribution schemes for functionally related products or to protect consumers from the results of malfunctioning equipment they cannot control. In some cases, the threat of antitrust liability even deters American companies from developing new technology.

If anyone doubts the reason for concern, let us just watch some of our competitor nations and see where they show, I would say, at least a more realistic attitude, and why they are able to outcompete us.

So what we are going to do in this act will require courts in antitrust cases to evaluate agreements to convey intellectual property rights under the "rule of reason" standard rather than the per se rule. This means that courts will have to consider all the relevant competitive factors in such agreements, including procompetitive factors.

The bill does not exempt any conduct from antitrust laws. It simply makes sure that the courts condemn as illegal only those agreements that really are anticompetitive.

With the help of our expert witnesses today, we will explore: One, the effect our current antitrust laws have on agreements to convey intellectual property rights; two, the role that licensing plays in the creation, development and distribution of American technology; and three, how we can harmonize the procompetitive features of our intellectual property and antitrust laws.

[Statement of Senator Leahy and a copy of S. 438 follow:]

SENATOR PATRICK LEAHY
JOINT HEARING
SUBCOMMITTEE ON TECHNOLOGY AND THE LAW
AND THE SUBCOMMITTEE ON ANTITRUST, MONOPOLIES
AND BUSINESS RIGHTS
ON THE INTELLECTUAL PROPERTY ANTITRUST PROTECTION ACT
OCTOBER 20, 1987

The creative spirit of America's innovators has made our nation the world's leader in high technology. America's economic future rests on the shoulders of individual inventors and innovators working in small firms and large corporations. We need to encourage continued innovation in high technology and to help American inventors and businesses recoup their tremendous investment in research and development.

Several of my colleagues on the Technology and Antitrust Subcommittees have joined me in introducing S. 438 -- the Intellectual Property Antitrust Protection Act -- to do just that. This legislation will help America's businesses meet the challenges they face in domestic and international markets.

Our intellectual property and antitrust laws should operate together to encourage innovation by rewarding individual inventors and creators, and to promote competition by ensuring that those inventors and creators have access to open and competitive markets. Nonetheless, it is almost common for business people and scholars to say that our antitrust and intellectual property laws are in conflict. They say this because the misguided notion that our intellectual property laws grant economic monopolies has led to unnecessarily harsh treatment of patents and copyrights in antitrust cases.

As a result, American businesses may be forced to avoid agreements that would permit them to cut costs by developing efficient distribution schemes for functionally related products or to protect consumers from the results of malfunctioning equipment they cannot control. In some cases, the threat of antitrust liability even deters American companies from developing new technology.

The Intellectual Property Antitrust Protection Act will require courts in antitrust cases to evaluate agreements to convey intellectual property rights under the "rule of reason" standard, rather than the per se rule. This means that courts will have to consider all the relevant competitive factors in such agreements, including procompetitive factors.

The bill does not exempt any conduct from the antitrust laws. It simply makes sure that the courts condemn as illegal only those agreements that are, in fact, anticompetitive. As to those agreements, the bill would limit damages to actual damages plus interest and attorneys' fees.

With the help of our expert witnesses today, we will explore:

- o The effect our current antitrust laws have on agreements to convey intellectual property rights.

- o The role that licensing plays in the creation, development, and distribution of American technology.

- o And how we can harmonize the procompetitive features of our intellectual property and antitrust laws.

I am delighted to welcome our witnesses to today's hearing and look forward to their testimony.

100TH CONGRESS
1ST SESSION

S. 438

To modify the application of the antitrust laws to encourage the licensing and other use of certain intellectual property.

IN THE SENATE OF THE UNITED STATES

FEBRUARY 3, 1987

Mr. LEAHY (for himself, Mr. HATCH, Mr. THURMOND, and Mr. HUMPHREY) introduced the following bill; which was read twice and referred to the Committee on the Judiciary

A BILL

To modify the application of the antitrust laws to encourage the licensing and other use of certain intellectual property.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*

3 **SECTION 1. SHORT TITLE.**

4 This Act may be cited as the "Intellectual Property
5 Antitrust Protection Act of 1987".

6 **SEC. 2. RULE OF REASON STANDARD.**

7 Agreements to convey rights—

8 (1) to use, practice, or sublicense an invention
9 patented under title 35 of the United States Code,

10 (2) to use or sublicense a trade secret, or

1 (3) in a work protected under title 17 of the
2 United States Code, or in a mask work protected
3 under chapter 9 of such title,
4 shall not be deemed to be illegal per se under any of the
5 antitrust laws.

6 SEC. 3. LIMITATION ON RELIEF.

7 (a) PRIVATE ACTIONS.—Notwithstanding section 4 of
8 the Clayton Act (15 U.S.C. 15) and in lieu of the relief speci-
9 fied in such section, any person who is entitled to recover on
10 a claim under such section, based on an agreement to which
11 section 2 of this Act applies, shall recover the actual dam-
12 ages sustained by such person, interest determined in accord-
13 ance with subsection (c) on such actual damages, and the cost
14 of such action, including a reasonable attorney's fee.

15 (b) ACTIONS BY STATE ATTORNEYS GENERAL.—Not-
16 withstanding section 4C of the Clayton Act (15 U.S.C. 15c)
17 and in lieu of the relief specified in such section, any State
18 that is entitled to monetary relief under such section based on
19 an agreement to which section 2 of this Act applies shall be
20 awarded as monetary relief the total damage sustained as
21 described in section 4C(a)(1) of the Clayton Act, interest de-
22 termined in accordance with subsection (c) of this section on
23 such total damage, and the cost of such action, including a
24 reasonable attorney's fee.

1 (c) DETERMINATION OF INTEREST.—For purposes of
2 subsections (a) and (b), interest shall be payable at the rate
3 specified in section 1961 of title 28, United States Code, for
4 the period beginning on the date of service of the pleading
5 setting forth the claim involved and ending on the date of
6 judgment, unless the court finds that awarding all or part of
7 such interest is unjust under the circumstances.

8 SEC. 4. DEFINITIONS.

9 For purposes of this Act—

10 (1) the term “antitrust laws” has the meaning
11 given it in subsection (a) of the first section of the
12 Clayton Act (15 U.S.C. 12(a)),

13 (2) the term “invention” has the meaning given it
14 in section 100(a) of title 35, United States Code, and

15 (3) the term “mask work” has the meaning given
16 it in section 901(a)(2) of title 17, United States Code.

○

Senator LEAHY. Before we begin with our first witness, we do have a statement from Senator Hatch to place in the record at this time.

[The prepared statement of Senator Hatch follows:]

OPENING STATEMENT OF HON. ORRIN G. HATCH, A U.S. SENATOR FROM THE STATE OF UTAH

Mr. Chairman, I am pleased to take part in this examination of S. 438, the Intellectual Property Antitrust Protection Act, legislation which would reform our nation's intellectual property laws. It is important that we explore these issues and promptly consider legislation which would improve U.S. competitiveness and benefit U.S. consumers by promoting technology innovation.

I believe legislation of this type is a necessary element of our efforts to provide U.S. companies the environment they need to stay competitive in world markets and it is a key part of the administration's intellectual property initiatives. The proposed bill would allow all intellectual property, not just jointly created property, to be developed and marketed in an efficient and procompetitive manner.

The requirement that agreements to convey intellectual property rights be evaluated on the bases of their reasonableness is a key part of the administration's intellectual property initiatives. We have already considered the portion of these proposals protecting intellectual property, including process patents, from unfair import competition.

It is important that we move forward quickly to remove unnecessary impediments to the development and marketing of new technologies. Some recent judicial decisions have created uncertainty in the high-technology community by invalidating licensing practices which do not have anticompetitive consequences. By not considering all competitive effects of agreements involving intellectual property rights, such decisions subject U.S. companies to possible treble damages liability for normal competitive practices which do not harm competition. Such decisions have the effect of discouraging technological innovation at the very time it is of great importance to the U.S. competitiveness that it be promoted. The proposed legislation would send a reliable signal to the courts and the business community that would encourage, rather than discourage, technological innovation.

We need to continue the task of insuring that the antitrust laws and intellectual property laws do not work at cross-purposes, harming U.S. competitiveness. S. 438 would lessen this tension by continuing to ban practices shown to be anticompetitive under an analysis of all competitive conditions. But more importantly, this bill would prevent courts from invalidating practices which do not have anticompetitive consequences, and which in fact are procompetitive and encourage the development of intellectual property. This clarification of our antitrust laws will help American high-technology companies to compete effectively in the highly competitive international marketplace.

I look forward to hearing the testimony of our witnesses today and to early consideration by the subcommittee of this legislation.

Senator LEAHY. I am glad to recognize our first witness, a distinguished Member of the House of Representatives, Congressman Hamilton Fish, not only a distinguished Member but also a good friend. I yield to you.

STATEMENT OF HON. HAMILTON FISH, JR., MEMBER OF CONGRESS, STATE OF NEW YORK, ACCOMPANIED BY ALAN COFFEY, MINORITY CHIEF COUNSEL, HOUSE JUDICIARY COMMITTEE

Mr. FISH. Thank you very much, Mr. Chairman.

With your permission, I am joined at the table by the minority chief counsel of the House Judiciary Committee, Mr. Alan Coffey.

I very much appreciate the opportunity to appear today and participate in these joint subcommittee hearings on the proposed Intellectual Property Antitrust Protection Act of 1987. You will find an echo in my remarks of your opening statement, Mr. Chairman, in the summary of the essence of what brings us here today. I would

like to publicly thank you for taking the legislative initiative regarding intellectual property licensing legislation in the U.S. Senate. Your leadership is a most welcome and positive sign.

As you know, our two bills differ as to certain subsidiary aspects, but both S. 438 and H.R. 557 are identical with respect to their principal provisions. That is, they both would apply the rule of reason standard to intellectual property license transactions and provide for the recovery of actual, rather than treble, damages in antitrust actions challenging such licensing agreements.

This is the second consecutive Congress in which I have introduced legislation in the House of Representatives dealing with this subject. Initially, I chose to pattern my bill after legislation suggested by the Departments of Justice and Commerce in 1983—the antitrust licensing provisions were contained in title III of that proposal, known as the National Productivity and Innovation Act.

A portion of that bill, dealing with the antitrust treatment of research and development joint ventures, became law, as you know, in 1984. But title III of that legislation never received the attention or close consideration it warranted.

I have taken a strong interest in this legislation for two principal reasons. First, I believe that the time is long overdue for the Congress to focus its attention on the intersection of antitrust law and intellectual property law. I have served on the House Judiciary Committee since 1969, and with the possible exception of enactment of the National Cooperative Research Act (P.L. 98-462), our committee has not addressed the problems presented by the overlap between these two important bodies of American law.

As this joint hearing reflects, the time has come for coordinated congressional focus on the proper relationship and balance between intellectual property rights and antitrust policy goals. How best to reconcile these rights and goals has been a matter of legal uncertainty and confusion for decades.

Mr. Chairman, my view is that the intellectual property laws and the antitrust laws serve complementary, not conflicting, functions in our Nation's economy. Unfortunately, in a number of major cases, a patent or a copyright has been characterized as a "monopoly," somehow inconsistent with the goals and aims of the Federal antitrust laws.

Both economic research and legal analysis in recent years have shown this artificial tension and conflict to be, at best, an oversimplification and, at worst, damaging to American productivity.

There is need, I believe, legislatively to reconcile the differences in judicial tests and theories, and that brings us to this point.

My second reason for becoming involved in this area legislatively is that I believe that there is a close correlation and linkage between the commitment to research and development, the protections offered by intellectual property laws, and, ultimately, the state of American competitiveness, which you so eloquently addressed in your opening remarks.

One need only look at our export statistics to conclude that those companies and industries that spend the most on research and development are the most successful in terms of their ability to export their products. Directly related to a company's willingness to undertake the commitment needed, in terms of dollars and time

for research and development, is whether or not that company believes there will be a favorable return—a financial reward—for such an investment.

The system of intellectual property law that we have in this country—principally patent law and copyright law—is a major ingredient in this reward process. A company's decision to initiate research and development is influenced by a number of factors. Mr. Chairman, there is no question but that one of the key factors in investment decisions is the prospect for licensing any intellectual property that may result.

Because of investment restrictions in a number of foreign countries, intellectual property licensing for many U.S. companies is the only prudent way to do business abroad. For example, in 1984, U.S. companies received \$7.5 billion in fees and royalties from foreign concerns as a result of intellectual property licenses.

This brings me specifically to intellectual property licensing, which is the focus of your legislation and mine. The presumption underlying S. 438 and H.R. 557 is that the transfer of intellectual property rights should be encouraged, rather than discouraged, by the Federal antitrust laws.

Patent licensing, for example, has the potential for significant procompetitive benefits. Often, the creator of a new product may not be in the best position to develop that particular product commercially. Other individuals or businesses may have superior manufacturing capabilities or product distribution networks. Transactions including the conveyance of intellectual property rights permit the patent owner to match its own knowledge and other advantages with those of its licensees, who may possess superior production, distribution, or marketing facilities or skills.

Licenses, and certain conditions included within such licenses, can also reduce the costs of transactions in transferring intellectual property and assessing the risk of developing new products. By allowing products to get to the marketplace more quickly or at lower cost, licensing can allow patent owners to compete more effectively.

The antitrust problem issues are particularly brought into play by such licensing arrangements when patentees or copyright holders place "conditions" on the license. The word "conditions," in this context, usually means some form of tying arrangement.

Now, traditionally, antitrust law has taken a dim view of such agreements, seeing them as economically sinister and inherently anticompetitive. To be sure, some licensing practices deserve to be deemed unlawful—those specifying a minimum price on the resale of a patented item, for example.

But not all licensing agreements deserve to be treated alike. Nonprice conditions in such agreements may, in fact, be procompetitive. Also, a court should look carefully at the actual market share of a tying product to determine its real antitrust consequences. My point being that some traditional antitrust tying analysis does not make sense, particularly in a high-technology setting where the packaging of hardware and software by growing, innovative companies is a key element in staying competitive.

As I mentioned before, there is a lengthy history of judicial hostility toward patent/copyright licensing. Most of the cases that demonstrate this historic tension between the intellectual property

laws and the antitrust laws involve tying arrangements. The *International Salt* case, for example, stands for the proposition that a tie-in in which the tying product is patented is per se illegal.

Now, following these two cases, the courts in nonpatent copyright cases began to more closely to examine the actual economic harm presented by particular tying arrangements. The courts began to recognize the need to look at the seller's real market position—that is, does the seller possess market dominance in the tying product, or does the seller have “sufficient economic power . . . to appreciably restrain free competition” in the marketplace with respect to the tied product.

The analysis, then, began to turn on whether the seller had the sufficient or requisite economic power to force a buyer to purchase a product that the buyer otherwise would not buy or could purchase elsewhere on different terms.

So, Mr. Chairman, the courts with respect to these tying arrangements analyzed the market situation and were moving toward a rule of reason analysis.

But with respect to patented and copyrighted products, no such market-share analysis was applied. The mere existence of a patent or copyright on the tying product presumes that the requisite economic power is always present. This automatic presumption that economic power is always present if the tying product is protected by the intellectual property laws has prompted considerable critical commentary.

The Columbia Law Review Article—and I quote from it:

Patents and copyrights are sometimes quite valuable and give to their owner a degree of market power. More often than not, however, a patent or copyright provides little, if any, market power. Thus, the presumption of sufficient market power leading to a per se condemnation of a tying arrangement involving such products is unwarranted. . . . Tying arrangements involving patented or copyrighted products should be treated like other tying arrangements and should only be condemned upon a showing of actual economic power.

The recent case law, Mr. Chairman, further points up the legal confusion in this area. For example, dicta in the majority opinion in the case of *Jefferson Parish Hospital District No. 2 et al. v. Hyde* was supportive of the presumption of per se illegality where the tying product is patented.

Justice O'Connor, joined by Justices Burger, Powell, and Rehnquist, filed a concurring opinion criticizing the presumption in patent/copyright cases and urging the application of the rule of reason—and abandonment of the per se rule—in all tying cases.

I quote from Justice O'Connor's opinion:

A common misconception has been that a patent or copyright, a high market share, or a unique product that competitors are not able to offer suffice to demonstrate market power. While each of these three factors might help to give market power to a seller, it is also possible that a seller in these situations will have no market power: for example, a patent holder has no market power in any relevant sense if there are close substitutes for the patented product. Similarly, a high market share indicates market power only if the market is properly defined to include all reasonable substitutes for the product.

A recent ninth circuit case held that a copyright for a computer operating system created a presumption of market power, so as to be sufficient to render a tying arrangement illegal per se without

further inquiry into the market situation. This, of course, is the *Data General Corporation* case.

The court of appeals reversed a district court decision in favor of the defendant, Data General, ruling that the district court had erred in requiring proof that Data General possessed significant economic power in the whole of the relevant market. Thus, the *Data General* decision threatens to impose treble damage liability on all firms in the computer industry that engage in the common practice of selling hardware-software packages.

In contrast, the sixth circuit has ruled that requisite economic power for a tie-in would not be presumed merely because the tying product was copyrighted. Instead, the court of appeals looked at the defendant's market share of the tying product. They found it to be 2 to 4 percent, and concluded that its share of the small computer market was so insignificant that it "could not coerce customers into buying an unwanted tied product."

The enactment of your bill, Mr. Chairman, would go a long way toward resolving the antitrust dilemma currently faced by companies that want to conditionally convey their rights in intellectual property. The application of the rule of reason to all transfers of intellectual property is intended to abolish the automatic presumption that market power is present simply because the tying product has a patent or a copyright.

I should emphasize, at this point, that it was never my intent to sanction or protect licensing conditions relating to price—horizontal or vertical—in this legislation. Concerns have been expressed and questions raised as to whether the language of this legislation would permit a licensor to impose specified or minimum prices on the resale of patented or copyrighted items. As I stated at the April 30 hearing held by the Subcommittee on Monopolies and Commercial Law of the House Judiciary Committee—that was never my intention. This legislation is aimed at nonprice conditions only. In fact, I would strongly urge you that clarifying language be added to the bill to make it clear that any agreement, arrangement, or condition relating to price should be excluded from its protections.

I also recognize that some concerns have been raised with respect to the types of intellectual property covered by this legislation. Your version, Mr. Chairman, includes trade secrets as well as patents and copyrights. My bill goes beyond S. 438 by covering trade secrets and "know-how" arising out of those trade secrets.

Some have expressed concerns that if the protections of this legislation go beyond patents, copyrights, and semiconductor chips, that there will be difficult definitional problems presented to the courts. I recognize this. My desire, then as now, is to enhance transfers of intellectual property. However, I do understand the fact that there is a widely recognized Federal body of law with respect to patents and copyrights that does not now exist with respect to trade secrets and related "know-how."

I would also request at this point that a letter from the Department of Justice regarding the prejudgment interest provisions of my bill be inserted in the record.

Senator LEAHY. Without objection.

Mr. FISH. It was sent to House Judiciary Committee Chairman Peter Rodino on June 24, 1987, in followup testimony received from

the Department on H.R. 557. The contents of this letter may be helpful to the members of your two subcommittees in dealing with the technicalities of the prejudgment interest issue.

In conclusion, I want to reiterate that traditional antitrust analysis on intellectual property licensing agreements has increasingly become outdated in a high-technology setting. It is self-defeating for an American body of law to impose restrictions on American companies with no real discernible benefit to consumers.

The presumption of market power, as it has been frequently applied in the courts to licenses involving intellectual property, is simply bad law and should be overturned. With the exception of an agreement involving price, intellectual property licenses should be judged under a rule of reason standard.

Mr. Chairman, I would like to mention now some of the endorsements of this legislation. The legislation has been endorsed by the American Intellectual Property Law Association, the National Association of Manufacturers, and the Business Roundtable. It is also interesting to note that the American Bar Association's Section on Antitrust, an outside disinterested body, have written favorably about the principles embodied in the legislation.

I thank you again, Chairman Leahy and members of the Senate Judiciary Committee, for your courtesy in allowing me to testify today, and I look forward to working with you toward the ultimate enactment of S. 438.

[Prepared statement of Congressman Fish and letter from the DOJ follow:]

TESTIMONY OF THE HONORABLE HAMILTON FISH, JR.

ON

"THE INTELLECTUAL PROPERTY ANTITRUST PROTECTION ACT OF 1987"
(S. 438)

BEFORE

THE SUBCOMMITTEE ON TECHNOLOGY AND THE LAW
AND
THE SUBCOMMITTEE ON ANTITRUST, MONOPOLIES, AND BUSINESS RIGHTS

COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

OCTOBER 20, 1987

THANK YOU, CHAIRMAN LEAHY AND CHAIRMAN METZENBAUM. I VERY MUCH APPRECIATE THE OPPORTUNITY TO APPEAR TODAY AND PARTICIPATE IN THESE JOINT SUBCOMMITTEE HEARINGS ON THE PROPOSED "INTELLECTUAL PROPERTY ANTITRUST PROTECTION ACT OF 1987" (S. 438).

AT THE OUTSET, I WOULD LIKE TO TAKE THIS OPPORTUNITY TO PUBLICLY THANK CHAIRMAN LEAHY FOR TAKING THE LEGISLATIVE INITIATIVE REGARDING INTELLECTUAL PROPERTY LICENSING LEGISLATION IN THE UNITED STATES SENATE. HIS LEADERSHIP IS, AND HAS BEEN, A MOST WELCOME AND POSITIVE SIGN. WHILE OUR TWO BILLS DIFFER AS TO CERTAIN SUBSIDIARY ASPECTS, BOTH S. 438 AND H.R. 557 ARE IDENTICAL WITH RESPECT TO THEIR PRINCIPAL PROVISIONS. THAT IS, THEY BOTH WOULD APPLY THE RULE OF REASON STANDARD TO INTELLECTUAL PROPERTY LICENSE TRANSACTIONS, AND PROVIDE FOR THE RECOVERY OF ACTUAL, RATHER THAN TREBLE, DAMAGES IN ANTITRUST ACTIONS CHALLENGING SUCH LICENSING AGREEMENTS.

THIS IS THE SECOND CONSECUTIVE CONGRESS IN WHICH I HAVE INTRODUCED LEGISLATION IN THE HOUSE OF REPRESENTATIVES DEALING WITH THIS SUBJECT. INITIALLY, I CHOSE TO PATTERN MY BILL AFTER LEGISLATION SUGGESTED BY THE DEPARTMENTS OF JUSTICE AND COMMERCE IN 1985 -- THE ANTITRUST LICENSING PROVISIONS WERE CONTAINED IN TITLE III OF THAT PROPOSAL, KNOWN AS THE "NATIONAL PRODUCTIVITY AND INNOVATION ACT". A PORTION OF THAT BILL, DEALING WITH ANTITRUST TREATMENT OF RESEARCH AND DEVELOPMENT JOINT VENTURES, BECAME LAW IN 1984. BUT TITLE III OF THAT LEGISLATION NEVER RECEIVED THE ATTENTION OR CLOSE CONSIDERATION IT WARRANTED.

I HAVE TAKEN A STRONG INTEREST IN THIS LEGISLATION FOR TWO PRINCIPAL REASONS. FIRST, I BELIEVE THAT THE TIME IS LONG OVERDUE FOR THE CONGRESS TO FOCUS ITS ATTENTION ON THE INTERSECTION OF ANTITRUST LAW AND INTELLECTUAL PROPERTY LAW. I HAVE SERVED ON THE JUDICIARY COMMITTEE IN THE HOUSE OF REPRESENTATIVES SINCE 1969, AND WITH THE POSSIBLE EXCEPTION OF ENACTMENT OF THE NATIONAL COOPERATIVE RESEARCH ACT (P.L. 98-462), OUR COMMITTEE HAS NOT ADDRESSED THE PROBLEMS PRESENTED BY THE OVERLAP BETWEEN THESE TWO IMPORTANT BODIES OF AMERICAN LAW. THIS SITUATION HAS BEEN FURTHER COMPLICATED BY THE FACT THAT ON THE HOUSE SIDE, INTELLECTUAL PROPERTY MATTERS FALL UNDER THE JURISDICTIONAL AUSPICES OF ONE SUBCOMMITTEE, WHILE PROPOSED AMENDMENTS TO THE FEDERAL ANTITRUST LAWS ARE CONSIDERED IN ANOTHER SUBCOMMITTEE. THESE OBSERVATIONS ARE NOT AT ALL INTENDED TO BE CRITICAL OF THE LEADERSHIP OF MY COMMITTEE; MY ONLY POINT IS THAT SUBCOMMITTEE JURISDICTION HAS ARTIFICIALLY AND UNWITTINGLY INTERFERED WITH A COMPREHENSIVE OVERVIEW.

AS THIS JOINT HEARING REFLECTS, THE TIME HAS COME FOR A COORDINATED CONGRESSIONAL FOCUS ON THE PROPER RELATIONSHIP AND BALANCE BETWEEN INTELLECTUAL PROPERTY RIGHTS AND ANTITRUST POLICY GOALS. HOW BEST TO RECONCILE THESE RIGHTS AND GOALS HAS BEEN A MATTER OF LEGAL UNCERTAINTY AND CONFUSION FOR DECADES. MY VIEW IS THAT THE INTELLECTUAL PROPERTY LAWS AND THE ANTITRUST LAWS SERVE COMPLEMENTARY, NOT CONFLICTING, FUNCTIONS IN OUR NATION'S ECONOMY. UNFORTUNATELY, IN A NUMBER OF MAJOR CASES, A PATENT OR A COPYRIGHT HAS BEEN CHARACTERIZED AS A "MONOPOLY",

SOMEHOW INCONSISTENT WITH THE GOALS AND AIMS OF THE FEDERAL ANTITRUST LAWS. BOTH ECONOMIC RESEARCH AND LEGAL ANALYSIS IN RECENT YEARS HAVE SHOWN THIS ARTIFICIAL TENSION AND CONFLICT TO BE, AT BEST, AN OVERSIMPLIFICATION AND, AT WORST, DAMAGING TO AMERICAN PRODUCTIVITY.

MY SECOND REASON FOR BECOMING INVOLVED IN THIS AREA LEGISLATIVELY IS THAT I BELIEVE THAT THERE IS A CLOSE CORRELATION AND LINKAGE BETWEEN THE COMMITMENT TO RESEARCH AND DEVELOPMENT, THE PROTECTIONS OFFERED BY INTELLECTUAL PROPERTY LAWS, AND, ULTIMATELY, THE STATE OF AMERICAN COMPETITIVENESS. ONE NEED ONLY LOOK AT OUR EXPORT STATISTICS TO CONCLUDE THAT THOSE COMPANIES AND INDUSTRIES THAT SPEND THE MOST ON RESEARCH AND DEVELOPMENT ARE THE MOST SUCCESSFUL IN TERMS OF THEIR ABILITY TO EXPORT THEIR PRODUCTS. 1/ DIRECTLY RELATED TO A COMPANY'S WILLINGNESS TO UNDERTAKE THE COMMITMENT NEEDED, IN TERMS OF DOLLARS AND TIME FOR RESEARCH AND DEVELOPMENT, IS WHETHER OR NOT THAT COMPANY BELIEVES THERE WILL BE A FAVORABLE RETURN -- A FINANCIAL REWARD -- FOR SUCH AN INVESTMENT.

THE SYSTEM OF INTELLECTUAL PROPERTY LAW THAT WE HAVE IN THIS COUNTRY -- PRINCIPALLY PATENT LAW AND COPYRIGHT LAW -- IS A MAJOR INGREDIENT IN THIS REWARD PROCESS. A COMPANY'S DECISION TO INITIATE RESEARCH AND DEVELOPMENT IS INFLUENCED BY A NUMBER OF

1/ U.S. DEPARTMENT OF COMMERCE, REPORT ON PATENT POLICY, INDUSTRIAL ADVISORY SUBCOMMITTEE ON PATENT AND INFORMATION POLICY TO THE SUBCOMMITTEE ON INDUSTRIAL INNOVATION, FEBRUARY 6, 1979, PP. 151-2. PAUL S. HOFF, INVENTIONS IN THE MARKETPLACE: PATENT LICENSING AND THE U.S. ANTITRUST LAWS (WASHINGTON: AMERICAN ENTERPRISE INSTITUTE, 1986), PP. 5-8.

FACTORS. THERE IS NO QUESTION BUT THAT ONE OF THE KEY FACTORS IS THE PROSPECT FOR LICENSING ANY INTELLECTUAL PROPERTY THAT MAY RESULT. BECAUSE OF INVESTMENT RESTRICTIONS IN A NUMBER OF FOREIGN COUNTRIES, INTELLECTUAL PROPERTY LICENSING FOR MANY U.S. COMPANIES IS THE ONLY PRUDENT WAY TO DO BUSINESS ABROAD. FOR EXAMPLE, IN 1984, U.S. COMPANIES RECEIVED \$7.5 BILLION IN FEES AND ROYALTIES FROM FOREIGN CONCERNS AS A RESULT OF INTELLECTUAL PROPERTY LICENSES.

THIS BRINGS ME SPECIFICALLY TO INTELLECTUAL PROPERTY LICENSING, WHICH IS THE FOCUS OF THE LEGISLATION INTRODUCED BY CHAIRMAN LEAHY AND MYSELF. THE PRESUMPTION UNDERLYING S. 438 AND H.R. 557 IS THAT THE TRANSFER OF INTELLECTUAL PROPERTY RIGHTS SHOULD BE ENCOURAGED, RATHER THAN DISCOURAGED, BY THE FEDERAL ANTITRUST LAWS.

PATENT LICENSING, FOR EXAMPLE, HAS THE POTENTIAL FOR SIGNIFICANT PROCOMPETITIVE BENEFITS. OFTEN, THE CREATOR OF A NEW PRODUCT MAY NOT BE IN THE BEST POSITION TO DEVELOP THAT PARTICULAR PRODUCT COMMERCIALY. OTHER INDIVIDUALS OR BUSINESSES MAY HAVE SUPERIOR MANUFACTURING CAPABILITIES OR PRODUCT DISTRIBUTION NETWORKS. TRANSACTIONS INCLUDING THE CONVEYANCE OF INTELLECTUAL PROPERTY RIGHTS PERMIT THE PATENT OWNER TO MATCH ITS OWN KNOWLEDGE AND OTHER ADVANTAGES WITH THOSE OF ITS LICENSEES, WHO MAY POSSESS SUPERIOR PRODUCTION, DISTRIBUTION, OR MARKETING FACILITIES OR SKILLS. LICENSES, AND CERTAIN CONDITIONS INCLUDED WITHIN SUCH LICENSES, CAN ALSO REDUCE THE COSTS OF TRANSACTIONS

IN TRANSFERRING INTELLECTUAL PROPERTY AND ASSESSING THE RISK OF DEVELOPING NEW PRODUCTS. BY ALLOWING PRODUCTS TO GET TO THE MARKETPLACE MORE QUICKLY OR AT LOWER COST, LICENSING CAN ALLOW PATENT OWNERS TO COMPETE MORE EFFECTIVELY.

THE ANTITRUST PROBLEM ISSUES ARE PARTICULARLY BROUGHT INTO PLAY BY SUCH LICENSING ARRANGEMENTS WHEN PATENTEES OR COPYRIGHT HOLDERS PLACE "CONDITIONS" ON THE LICENSE. THE WORD "CONDITIONS", IN THIS CONTEXT, USUALLY MEANS SOME FORM OF TYING ARRANGEMENT. 2/ NOW, TRADITIONALLY, ANTITRUST LAW HAS TAKEN A DIM VIEW OF SUCH AGREEMENTS -- SEEING THEM AS ECONOMICALLY SINISTER AND INHERENTLY ANTICOMPETITIVE. TO BE SURE, SOME LICENSING PRACTICES DESERVE TO BE DEEMED UNLAWFUL -- THOSE SPECIFYING A MINIMUM PRICE ON THE RESALE OF THE PATENTED ITEM, FOR EXAMPLE.

BUT NOT ALL LICENSING AGREEMENTS DESERVE TO BE TREATED ALIKE. NON-PRICE CONDITIONS IN SUCH AGREEMENTS MAY, IN FACT, BE PROCOMPETITIVE. ALSO, A COURT SHOULD LOOK CAREFULLY AT THE ACTUAL MARKET SHARE OF A TYING PRODUCT TO DETERMINE ITS REAL ANTITRUST CONSEQUENCES. MY POINT BEING THAT SOME TRADITIONAL ANTITRUST TYING ANALYSIS DOES NOT MAKE SENSE, PARTICULARLY IN A HIGH-TECHNOLOGY SETTING WHERE THE PACKAGING OF HARDWARE AND SOFTWARE IS A KEY ELEMENT IN STAYING COMPETITIVE.

2/ TYPICALLY, A TYING ARRANGEMENT IS AN AGREEMENT BY ONE PARTY TO SELL A PRODUCT (THE "TYING PRODUCT"), BUT ONLY ON THE CONDITION THAT THE BUYER ALSO PURCHASES ANOTHER RELATED (I.E., "TIED") PRODUCT, OR AT LEAST AGREES NOT TO PURCHASE THAT TIED PRODUCT FROM ANOTHER SUPPLIER.

AS MENTIONED BEFORE, THERE IS A LENGTHY HISTORY OF JUDICIAL HOSTILITY TOWARD PATENT/COPYRIGHT LICENSING. MOST OF THE CASES THAT DEMONSTRATE THIS HISTORIC TENSION BETWEEN THE INTELLECTUAL PROPERTY LAWS AND ANTITRUST LAWS INVOLVE "TYING ARRANGEMENTS". THE INTERNATIONAL SALT CASE, FOR EXAMPLE, STANDS FOR THE PROPOSITION THAT A TIE-IN IN WHICH THE TYING PRODUCT IS PATENTED IS PER SE ILLEGAL. INTERNATIONAL SALT Co. v. UNITED STATES, 332 U.S. 392, 395-96 (1947). THE SUPREME COURT HAS ALSO HELD THAT TYING THE LICENSING OF A COPYRIGHTED FILM TO OTHER FILMS IS PER SE ILLEGAL. U.S. v. PARAMOUNT PICTURES, 334 U.S. 131, 156-59 (1948).

FOLLOWING THESE TWO CASES, THE COURTS BEGAN TO MORE CLOSELY EXAMINE THE ACTUAL ECONOMIC HARM PRESENTED BY PARTICULAR TYING ARRANGEMENTS. THE COURTS BEGAN TO RECOGNIZE THE NEED TO LOOK AT THE SELLER'S REAL MARKET POSITION -- I.E., DOES THE SELLER POSSESS MARKET DOMINANCE IN THE TYING PRODUCT OR DOES THE SELLER HAVE "SUFFICIENT ECONOMIC POWER . . . TO APPRECIABLY RESTRAIN FREE COMPETITION" IN THE MARKETPLACE WITH RESPECT TO THE TIED PRODUCT. SEE: NORTHERN PACIFIC RY. v. U.S., 356 U.S. 1, 6 (1958); TIMES-PICAYUNE PUBLISHING Co. v. U.S., 345 U.S. 594 (1953). THE ANALYSIS, THEN, BEGAN TO TURN ON WHETHER THE SELLER HAD THE SUFFICIENT OR REQUISITE ECONOMIC POWER TO FORCE A BUYER TO PURCHASE A PRODUCT THAT THE BUYER OTHERWISE WOULD NOT BUY OR COULD PURCHASE ELSEWHERE ON DIFFERENT TERMS.

BUT WITH RESPECT TO PATENTED OR COPYRIGHTED PRODUCTS, NO SUCH MARKET SHARE ANALYSIS WAS APPLIED. THE MERE EXISTENCE OF A

PATENT OR COPYRIGHT ON THE TYING PRODUCT PRESUMES THAT THE REQUISITE ECONOMIC POWER IS ALWAYS PRESENT. U.S. v. LOEW'S INC., 371 U.S. 38, 45 (1962). THIS AUTOMATIC PRESUMPTION THAT ECONOMIC POWER IS ALWAYS PRESENT IF THE TYING PRODUCT IS PROTECTED BY THE INTELLECTUAL PROPERTY LAWS HAS PROMPTED CONSIDERABLE CRITICAL COMMENTARY.

"PATENTS AND COPYRIGHTS ARE SOMETIMES QUITE VALUABLE AND GIVE TO THEIR OWNER A DEGREE OF MARKET POWER. MORE OFTEN THAN NOT, HOWEVER, A PATENT OR COPYRIGHT PROVIDES LITTLE, IF ANY, MARKET POWER. THUS, THE PRESUMPTION OF SUFFICIENT MARKET POWER LEADING TO A PER SE CONDEMNATION OF A TYING ARRANGEMENT INVOLVING SUCH PRODUCTS IS UNWARRANTED. . . TYING ARRANGEMENTS INVOLVING PATENTED OR COPYRIGHTED PRODUCTS SHOULD BE TREATED LIKE OTHER TYING ARRANGEMENTS AND SHOULD ONLY BE CONDEMNED UPON A SHOWING OF ACTUAL ECONOMIC POWER."^{3/}

THE RECENT CASE LAW FURTHER POINTS UP THE LEGAL CONFUSION IN THIS AREA. FOR EXAMPLE, DICTA IN THE MAJORITY OPINION IN THE CASE OF JEFFERSON PARISH HOSPITAL DISTRICT NO. 2 ET AL. v. HYDE, WAS SUPPORTIVE OF THE PRESUMPTION OF PER SE ILLEGALITY WHERE THE TYING PRODUCT IS PATENTED. 104 S.Ct. 1551, 1560 (1984). JUSTICE O'CONNOR FILED A CONCURRING OPINION (JOINED BY JUSTICES BURGER, POWELL AND KEHNQUIST) CRITICIZING THE PRESUMPTION IN PATENT/-COPYRIGHT CASES AND URGING THE APPLICATION OF THE "RULE OF REASON" -- AND ABANDONMENT OF THE PER SE RULE -- IN ALL TYING CASES.

"A COMMON MISCONCEPTION HAS BEEN THAT A PATENT OR COPYRIGHT, A HIGH MARKET SHARE, OR A UNIQUE PRODUCT THAT COMPETITORS ARE NOT ABLE TO OFFER SUFFICE TO

^{3/} W. MONTGOMERY, THE PRESUMPTION OF ECONOMIC POWER FOR PATENTED AND COPYRIGHTED PRODUCTS IN TYING ARRANGEMENTS, 85 COLUM. L. REV. 1140, 1156 (1985).

DEMONSTRATE MARKET POWER. WHILE EACH OF THESE THREE FACTORS MIGHT HELP TO GIVE MARKET POWER TO A SELLER, IT IS ALSO POSSIBLE THAT A SELLER IN THESE SITUATIONS WILL HAVE NO MARKET POWER: FOR EXAMPLE, A PATENT HOLDER HAS NO MARKET POWER IN ANY RELEVANT SENSE IF THERE ARE CLOSE SUBSTITUTES FOR THE PATENTED PRODUCT. SIMILARLY, A HIGH MARKET SHARE INDICATES MARKET POWER ONLY IF THE MARKET IS PROPERLY DEFINED TO INCLUDE ALL REASONABLE SUBSTITUTES FOR THE PRODUCT."^{4/}

A RECENT 9TH CIRCUIT CASE HELD THAT A COPYRIGHT FOR A COMPUTER OPERATING SYSTEM CREATED A PRESUMPTION OF MARKET POWER, SO AS TO BE SUFFICIENT TO RENDER A TYING ARRANGEMENT ILLEGAL PER SE WITHOUT FURTHER INQUIRY INTO THE MARKET SITUATION. DYNAMIC CORP. V. DATA GENERAL CORP., 734 F.2d 1336 (1984). THE COURT OF APPEALS REVERSED A DISTRICT COURT DECISION IN FAVOR OF THE DEFENDANT (DATA GENERAL), RULING THAT THE DISTRICT COURT HAD ERRED IN REQUIRING PROOF THAT DATA GENERAL POSSESSED SIGNIFICANT ECONOMIC POWER IN THE WHOLE OF THE RELEVANT MARKET. THUS, THE DATA GENERAL DECISION THREATENS TO IMPOSE TREBLE DAMAGE LIABILITY ON ALL FIRMS IN THE COMPUTER INDUSTRY THAT ENGAGE IN THE COMMON PRACTICE OF SELLING HARDWARE-SOFTWARE PACKAGES.

IN CONTRAST, THE 6TH CIRCUIT HAS RULED THAT REQUISITE ECONOMIC POWER FOR A TIE-IN WOULD NOT BE PRESUMED MERELY BECAUSE THE TYING PRODUCT WAS COPYRIGHTED. A.I. ROOT CO. V. COMPUTER/DYNAMICS INC. AND MAI, INC., 806 F.2d 673 (1986).

^{4/} JEFFERSON PARISH V. HYDE, 466 U.S. AT 37, N. 7 (O'CONNOR, J., CONCURRING).

INSTEAD, THE COURT OF APPEALS LOOKED AT THE DEFENDANT'S MARKET SHARE OF THE TYING PRODUCT (2-4%) AND CONCLUDED THAT ITS SHARE OF THE SMALL COMPUTER MARKET WAS SO INSIGNIFICANT THAT IT "COULD NOT COERCE CUSTOMERS INTO BUYING AN UNWANTED TIED PRODUCT." 806 F.2D AT 677.

THE ENACTMENT OF S. 438 (AND H.R. 557) WOULD GO A LONG WAY TOWARDS RESOLVING THE ANTITRUST DILEMMA CURRENTLY FACED BY COMPANIES THAT WANT TO CONDITIONALLY CONVEY THEIR RIGHTS IN INTELLECTUAL PROPERTY. THE APPLICATION OF THE RULE OF REASON TO ALL TRANSFERS OF INTELLECTUAL PROPERTY IS INTENDED TO ABOLISH THE AUTOMATIC PRESUMPTION THAT MARKET POWER IS PRESENT SIMPLY BECAUSE THE TYING PRODUCT HAS A PATENT OR A COPYRIGHT. I SHOULD EMPHASIZE, AT THIS POINT, THAT IT WAS NEVER MY INTENT TO SANCTION OR PROTECT LICENSING CONDITIONS RELATING TO PRICE (HORIZONTAL OR VERTICAL) IN THIS LEGISLATION. CONCERNS HAVE BEEN EXPRESSED AND QUESTIONS RAISED AS TO WHETHER THE LANGUAGE OF THIS LEGISLATION WOULD PERMIT A LICENSOR TO IMPOSE SPECIFIED OR MINIMUM PRICES ON THE RESALE OF PATENTED OR COPYRIGHTED ITEMS. AS I STATED AT THE APRIL 30 HEARING HELD BY THE SUBCOMMITTEE ON MONOPOLIES AND COMMERCIAL LAW OF THE HOUSE JUDICIARY COMMITTEE -- THAT WAS NEVER MY INTENTION. THIS LEGISLATION IS AIMED AT NON-PRICE CONDITIONS ONLY. IN FACT, I WOULD STRONGLY URGE THAT CLARIFYING LANGUAGE BE ADDED TO THE BILL TO MAKE IT CLEAR THAT ANY AGREEMENT, ARRANGEMENT, OR CONDITION RELATING TO PRICE SHOULD BE EXCLUDED FROM ITS PROTECTIONS.

I ALSO RECOGNIZE THAT SOME CONCERNS HAVE BEEN RAISED WITH RESPECT TO THE TYPES OF INTELLECTUAL PROPERTY COVERED BY THIS LEGISLATION. CHAIRMAN LEAHY'S VERSION INCLUDES TRADE SECRETS AS WELL AS PATENTS AND COPYRIGHTS. MY BILL GOES BEYOND S. 438 BY COVERING TRADE SECRETS AND "KNOW HOW" ARISING OUT OF THOSE TRADE SECRETS. SOME HAVE EXPRESSED CONCERNS THAT IF THE PROTECTIONS OF THIS LEGISLATION GO BEYOND PATENTS, COPYRIGHTS, AND SEMICONDUCTOR CHIPS, THAT THERE WILL BE DIFFICULT DEFINITIONAL PROBLEMS PRESENTED TO THE COURTS. MY DESIRE, THEN AS NOW, IS TO ENHANCE TRANSFERS OF INTELLECTUAL PROPERTY. HOWEVER, I DO UNDERSTAND THE FACT THAT THERE IS A WIDELY RECOGNIZED FEDERAL BODY OF LAW WITH RESPECT TO PATENTS AND COPYRIGHTS, THAT DOES NOT NOW EXIST WITH RESPECT TO TRADE SECRETS AND RELATED "KNOW HOW".

I WOULD ALSO REQUEST AT THIS POINT, THAT A LETTER FROM THE DEPARTMENT OF JUSTICE REGARDING THE PREJUDGMENT INTEREST PROVISIONS OF MY BILL BE INSERTED IN THE RECORD. IT WAS SENT TO HOUSE JUDICIARY COMMITTEE CHAIRMAN PETER RODINO ON JUNE 24, 1987, IN FOLLOW UP TO TESTIMONY RECEIVED FROM THE DEPARTMENT OF JUSTICE ON H.R. 557. THE CONTENTS OF THIS LETTER MAY BE HELPFUL TO THE MEMBERS OF YOUR TWO SUBCOMMITTEES IN DEALING WITH THE TECHNICALITIES OF THE PREJUDGMENT INTEREST ISSUE.

IN CONCLUSION, I WANT TO REITERATE THAT TRADITIONAL ANTI-TRUST ANALYSIS ON INTELLECTUAL PROPERTY LICENSING AGREEMENTS HAS INCREASINGLY BECOME OUTDATED IN A HIGH-TECHNOLOGY SETTING. IT IS SELF-DEFEATING FOR AN AMERICAN BODY OF LAW TO IMPOSE RESTRICTIONS ON AMERICAN COMPANIES WITH NO REAL DISCERNIBLE BENEFIT TO CON-

SUMERS. THE PRESUMPTION OF MARKET POWER, AS IT HAS BEEN FREQUENTLY APPLIED IN THE COURTS TO LICENSES INVOLVING INTELLECTUAL PROPERTY, IS SIMPLY BAD LAW AND SHOULD BE OVERTURNED. WITH THE EXCEPTION OF AN AGREEMENT INVOLVING PRICE, INTELLECTUAL PROPERTY LICENSES SHOULD BE JUDGED UNDER A RULE OF REASON STANDARD.

THANK YOU, AGAIN, CHAIRMAN LEAHY, CHAIRMAN METZENBAUM, AND MEMBERS OF THE SENATE JUDICIARY COMMITTEE, FOR YOUR COURTESY IN ALLOWING ME TO TESTIFY HERE TODAY. I LOOK FORWARD TO WORKING WITH YOU TOWARD THE ULTIMATE SUCCESS OF S. 438.



U.S. Department of Justice

Antitrust Division

Office of the Deputy Assistant Attorney General

Washington, D.C. 20530

Honorable Peter W. Rodino, Jr.
Chairman, Subcommittee on Monopolies
and Commercial Law
Committee on the Judiciary
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

During my April 30, 1987, appearance before the Subcommittee at its hearing on H.R. 557, I indicated that I would promptly inform the Subcommittee of the Department of Justice's position on two areas of difference between H.R. 557 and the Administration's similar proposal for legislation regarding intellectual property licensing and the antitrust laws. As you noted at the hearing, H.R. 557 and the Administration's proposal, contained in H.R. 1155, differ with regard to the computation of prejudgment interest to be awarded on actual damages and with regard to whether inconsistent state antitrust laws covering licensing agreements would be preempted.

The computation of prejudgment interest under the Administration's proposal differs from such computation under H.R. 557 with respect both to the time period for which interest would be awarded and the interest rate prescribed. H.R. 1155 provides for prejudgment interest on damages "for the period beginning on the earliest date for which injury can be established" and ending on the date of judgment. Under H.R. 557, prejudgment interest on damages would run "beginning on the date of service of the pleading setting forth the claim involved" and ending on the date of judgment. The interest rate prescribed by both bills is the rate specified in 28 U.S.C. § 1961, 1/ but H.R. 1155 also allows the court to use

1/ The coupon yield equivalent of the average accepted auction price for the last auction of fifty-two week United States Treasury bills settled immediately prior to the date of judgment.

"such other rate as the court finds to be fair to fully compensate for the injury sustained." 2/

The Department of Justice would prefer the provisions governing computation of prejudgment interest that are contained in H.R. 1155. 3/ With actual damages instead of treble damages being awarded, recovery of interest from the date of injury is more important and enables those injured by antitrust violations to obtain full compensation, and would be consistent with the computation of prejudgment interest under the NCRA. 4/

In connection with passage of the NCRA, it was recognized that it may be difficult to determine the precise date on which injury occurred, and that it may be inequitable in certain circumstances to award prejudgment interest as calculated under the "earliest date" rule. 5/ Where the date of the onset of injury cannot be precisely determined, the plaintiff may prove that the injury began prior to a date certain and receive interest from that date. Where interest has been utilized in computing damages, and the award of prejudgment interest would thereby duplicate that portion of damages (e.g., where use of lost profits or interest thereon has already been factored into the damage award), or where litigation has been unreasonably delayed by the plaintiff, H.R. 1155, like the NCRA, gives the

2/ Both H.R. 557 and H.R. 1155 allow the court to reduce the award of prejudgment interest if "the court finds that awarding all or part of such interest is unjust in the circumstances."

3/ These provisions are identical to the provisions governing computation of prejudgment interest in the Administration's general proposal on treble damage reform, the "Antitrust Remedies Improvement Act of 1987." (See section 4112 of H.R. 1155.)

4/ See 15 U.S.C. § 4303(d); H.R. Conf. Rep. No. 1044, 98th Cong., 2d Sess. 13 (1984) ("This formulation is intended to allow an injured plaintiff to be fully compensated for injuries suffered."). Consistency with the NCRA on the details of prejudgment interest appears desirable as a general matter in view of the fact that both the NCRA and this legislation could be applicable to the same licensing conduct.

5/ See H.R. Conf. Rep. No. 1044, supra n. 4, at 13.

court flexibility to limit or withhold prejudgment interest. 6/ The degree of flexibility afforded by H.R. 1155, with regard both to setting a date from which interest will run and to limiting or withholding interest, may indicate that in practice, prejudgment interest awarded under H.R. 1155 in many circumstances would closely approximate what would be awarded under H.R. 557.

While, for the reasons I have described, the Department prefers the computation of interest set forth in the Administration's proposal over that contained in H.R. 557, the Department would continue strongly to support this legislation should Congress adopt the approach in H.R. 557. The differences between the two approaches to prejudgment interest are matters of very minor detail in comparison to the significance of this legislation generally.

The second area of difference between H.R. 557 and the Administration's proposal concerns preemption of state antitrust laws that are inconsistent with the bills' mandating of a rule of reason standard or the bills' detrebling of antitrust damages for the licensing agreements covered by the bills. H.R. 557 preempts such state laws; H.R. 1155 does not.

Once it has been determined that the object of a bill is a proper subject for federal action under the Commerce Clause or some other grant of authority to Congress under Article I of the Constitution, the question whether to include a state law preemption provision in the bill often arises. The question is normally a difficult one because it involves a weighing of fundamental federalism concerns against concerns that inconsistent state laws not be allowed to disrupt a national policy reflected in the legislation. In light of the principles of federalism which underlie our constitutional structure, the presumption must be against preemption. Advocates of preemption must meet a heavy burden to overcome

6/ The ability of the court under H.R. 1155 to vary the rate of interest from that set forth in 28 U.S.C. § 1961, a feature not found in the NCRA, reflects the fact that, in antitrust cases, damages may be recovered for injuries sustained many years prior to the date of judgment, during which interest rates may have been substantially lower (or higher) than current Treasury bill yields. The Department suggests that if this feature of H.R. 1155 is employed, the interest rate provisions of the NCRA (15 U.S.C. § 4303(a), (b), (c)) should be amended in order to provide such interest rate flexibility and preserve consistency between the NCRA and this legislation.

that presumption. In formulating its proposal in this instance, the Administration concluded that this burden had not been met. We believe that Congress should demand a strong showing that variations in state law pose a substantial threat to the national competitive and innovative policies to be fostered by this legislation before considering preemption. 7/

I also offered during my appearance to provide copies of recent speeches by Antitrust Division officials on antitrust analysis of intellectual property licensing arrangements. Three such speeches are enclosed.

I hope that this information is responsive to the questions that you raised regarding the differences between H.R. 557 and H.R. 1155. 8/ Thank you again for the opportunity to appear at the Subcommittee's hearing and present the Justice Department's views on this important legislation.

The Office of Management and Budget had advised this Department that there is no objection to the submission of these views from the standpoint of the Administration's program.

Sincerely,

Roger B. Andewelt
Deputy Assistant Attorney General

Enclosures

7/ The Administration's 1983 proposal to provide rule of reason treatment and make detrebling available for research and development joint ventures--a proposal that culminated in the enactment of the NCRA--did not contain state law preemption provisions. Congress apparently determined in that instance that state laws did in fact pose a threat to the goals of the NCRA sufficient to warrant preemption.

8/ One other difference between the bills involves the definition of "antitrust laws." Unlike H.R. 557, H.R. 1155 follows the lead of the NCRA by including within the term "antitrust laws" section 5 of the Federal Trade Commission Act (15 U.S.C. § 45) to the extent that section applies to unfair methods of competition. We recommend this approach to the Subcommittee.

Senator LEAHY. Thank you very much, Congressman. I found especially interesting comments on page 9 of your statement, where you said that, with respect to the legislation, it is aimed at only non-priced restrictions and intellectual property agreements. I am looking forward to working with you to clarify that point in our legislation. My staff has been working with yours, and I hope we can continue to do that, because it is a point that needs to be clarified.

Mr. FISH. It might be a good idea, yes.

Senator LEAHY. And also, I think we are both in complete agreement that it is self-defeating for our laws to inhibit innovation in the absence of being clear that a practice is anticompetitive. I think we are both aware of a number of practical benefits that can result from this legislation. I think maybe that is the thing we should be emphasizing most as we seek cosponsors in both bodies, to point out some of those advantages.

I thank you both very much for being here.

Mr. FISH. Thank you very much, Mr. Chairman. I look forward to continuing working with you.

Senator LEAHY. Thank you.

I understand the next panel may need a little bit of time to set up their demonstration, so we will take a 3-minute break while they set up.

[Short recess.]

Senator LEAHY. The next panel will have Sandy Feman, senior regional attorney, Medical Products Group, Hewlett-Packard, and Prof. Carl Shapiro, of Princeton University. They have with them a heart monitor.

I almost hate to tell the story, but in a previous incarnation prior to coming to the Senate, I was a prosecutor. And I recall once at a sentencing when the judge asked the defense attorney if his client had any last request before being sentenced. I had just made an impassioned plea to put him away, lock the door, and throw the key away.

And he suggested, "Just one." He said, "My client says that if he ever has to have a heart transplant, he wants a D.A.'s because it has never been used." [Laughter.]

I thus decline any opportunity to be hooked up to that machine today, just in case.

Your entire statements, of course, will be inserted in the record. I would ask you to summarize your testimony, and we will let you start whichever way you want.

Mr. Feman.

STATEMENTS OF A PANEL, INCLUDING SANDY FEMAN, SENIOR REGIONAL ATTORNEY, MEDICAL PRODUCTS GROUP, HEWLETT-PACKARD CO.; AND CARL SHAPIRO, PROFESSOR OF ECONOMICS AND PUBLIC AFFAIRS, PRINCETON UNIVERSITY

Mr. FEMAN. Good morning. My name is Sandy Feman, and I am a regional attorney at Hewlett-Packard Co.

For all but two of the 10 years that I have been an attorney, I have been working in factories, in high-technology companies, and those are the places where the marketing managers work and

where decisions are made as to how products are to be sold and priced.

Now I work at Hewlett-Packard Co. in the Medical Products Group, and I would like to explain to you what I have brought to the committee this morning, and I hope you will see its relevance as we go on.

This is a heart monitor, as you said, Senator. If you would imagine that a patient is sitting over here on my right where Professor Shapiro is, and that this box directly in front of me is the one that appears at the bedside, and it shows a heart rhythm and some pressures, if they are being measured, from the circulatory system of the patient.

Senator LEAHY. Professor Shapiro looks like he has made a remarkable recovery, but go ahead.

Mr. FEMAN. On my left is a central station monitor and a computer. And the difference between the two—and the whole system starts with the patient and goes all the way to the central station. So the nurses are sitting at the central station, looking at several bedsides at a time. And in that larger box is a computer which performs measurements on the heart rhythms to report as to whether the rhythms are normal or not normal.

So the output of the central station is either an alarm, if a dangerous rhythm is detected, and a strip of paper, which comes from the paper recorder that you can see. And on the top of the strip of the paper—and if it would not be a breach of decorum, I will pass this up to the subcommittee—we have a normal rhythm, and I have numbered that No. 1; we have one with ventricular tachycardia, and that means the ventricles are starting to pump too quickly, and right at the top, the computer has noticed that and diagnosed it. It is common that that would go into a ventricular fibrillation, which is another abnormal rhythm where the whole heart is kind of pumping out of control, too quickly, and not really pumping at all, and the computer has noticed that one. And here, we have a final loss of vitality in the heart, and the computer has noticed that, also.

These diagnoses are made by an algorithm, which we call our arrhythmia algorithm, and it is able to detect some 30 different arrhythmias and to report on them in this way.

The algorithm development began at Stanford University in the midseventies, and from then to now, it has continually been developed at Hewlett-Packard. An average of five engineers have worked on it at any given time over approximately 12 years.

The engineers are fond of pointing out to me that the number of engineers in that formula, five, and the number of years are equally important, and you cannot just substitute one for the other. And they are fond of saying that nine pregnant women cannot deliver a baby in 1 month, even though one can deliver a baby in 9 months.

Senator LEAHY. Isn't science wonderful? Go ahead.

Mr. FEMAN. I have also brought with me a circuit board which comes from the computer which is on my left. I point out to the committee that these two chips which have been marked in white are the ones on which the algorithm resides which performs the measurements on the heartbeats and produces the diagnoses. And that is embedded in software.

And it should not make a difference to the committee that we have chosen to put the algorithm on chips. We could easily have put the algorithm on a floppy disk or any other medium. The point of the chips is that the access time is quicker, and it is able to perform these calculations as the beats go on, rather than taking 2 or 3 or 4 seconds to perform the diagnosis. And as you can imagine, time is very important in this process.

The algorithm is widely used——

Senator LEAHY. So it works in virtual real time?

Mr. FEMAN. That is correct.

The algorithm is in fairly wide use. We estimate that some 800,000 patients are monitored on this algorithm each year, which means that any moment, like now, there are some 13,000 patients whose hearts are being monitored by the algorithm.

Typically, a patient is admitted to a coronary care unit after a coronary event, and the first 2 days are spent trying to stabilize the patient by reading the reports from the computer and changing the medication; but at the same time, you want to be alerted if there is any irregular algorithm so that you can intervene.

The current revision of the algorithm was subjected, before we sent it to the public, to a field trial. We estimate some 10,600 patient days at three different hospitals were used in testing the algorithm to make sure it works. The point of this is that it was not just the algorithm that was tested, but it was the algorithm in the equipment that was tested, and that if we were to take these chips out of the equipment and put it in other equipment, we would have to begin the field trial again. There is no assurance that the algorithm works outside the equipment.

Now I would like to focus the committee, if I could, on the *Digidyne and Data General* decision, which was mentioned in the previous testimony. That decision, as I understand it, gives Hewlett-Packard the option of protecting this software with a copyright or not, and the consequences are as follows. If we choose not to put the little "c" and copyright on the chip and on the software, then anyone can take the chip and duplicate it. How can they do that? Well, it is very simple. Let me tell you how we manufacture these chips.

We lay them in a PROM—"Programmable Read-Only Memory—burner, eight at a time, with one chip at the top and seven blank ones down below, and we turn it on, and several minutes later, we have eight identical chips.

Anyone can do it. There is nothing very tricky about it. We manufacture them, and anyone who wants to could take one, if it were not protected by copyright, and make as many as they want.

I have only 1 or 2 more minutes.

Senator LEAHY. Go ahead.

Mr. FEMAN. The alternative is to place the copyright restriction on it. And as I understand the decision, that immediately gives rise to a presumption that we have market power in the copyrighted product. We do not want to unbundle, and as in my statement I say, principally because we lose control of the quality of the final product and because we may be required in an emergency situation to repair competitive equipment which we do not make.

All of the good reasons pointed out in my testimony why we believe it is important that we keep the software connected to the system are part of what we understand as a rule of reason test. And the principal feature of the test set forth in the *Data General* case, which is one that says we must rebut market power, is that we are unable to bring forth the good reasons before the court in that test. The fact that we cannot control the quantity; the fact that if we unbundle, we must make our software compatible with other manufacturers' equipment; the fact that we have additional liability in the products-liability arena, and the fact that we may have to maintain our competitors' equipment are all good reasons, but unfortunately, the court will turn a deaf ear to them—in a market power test. But under the proposed legislation we would be able to put them before a court in a rule of reason test.

So for that reason Hewlett-Packard supports the bill as it is before the committee today, and I would like to thank you for your attention, and I would be happy to answer any questions at the conclusion of the panel.

Thank you.

[Statement, with attached copies of electrocardiograms, follow:]

TESTIMONY OF THE
HEWLETT PACKARD COMPANY
ON S. 438, THE INTELLECTUAL PROPERTY
ANTITRUST PROTECTION ACT
OCTOBER 20, 1987

Good morning. I am Sandy Feman, Senior Regional Attorney for the Medical Products Group of the Hewlett-Packard Company. On behalf of Hewlett Packard I would like to thank the committee for giving us this opportunity to express our comments with respect S. 438, which would provide a Rule of Reason for anti-trust analysis of agreements to convey rights in intellectual property. We commend Senators Leahy and Metzenbaum for holding joint subcommittee hearings on this important issue, and we applaud Senators Leahy, Hatch, Thurmond, Humphrey, Baucus and DeConcini for their role in introducing and co-sponsoring this legislation.

Let me begin by saying that I am not an antitrust expert. For the ten years that I have been practicing law, I have been what we call an in-house general attorney. I am located in one of HP's factories, and, like my counterparts in HP and in other high-tech companies throughout the country, I pride myself in understanding and dealing with the numerous practical day to day issues in our business. This includes counseling of marketing personnel with respect to contracts, generally, and what is casually known as "antitrust counselling" when the need arises.

With the exception of major changes in marketing or pricing strategy, many antitrust decisions are made at the level at which I work, in the factory or in the field, far from corporate headquarters, and even farther from the highly specialized services of attorneys who specialize solely in antitrust counseling and litigation.

Most marketing professionals know that there are relevant antitrust considerations out there somewhere. Most are also aware that these rules are often counter-intuitive and, thus, they also know that they must seek expert advice and not rely on their instinct or their feelings of what is right and what is wrong. They know that they ought to seek advice, and they often do.

Therefore, and this is our first comment with respect to the bill: anything which will clarify the rules will go a long way towards bringing about order, conformity with the rules, and a levelling of the field on which we all play.

Passing the Leahy-Fish bill will do that in two ways: first, by clarifying the rules, it will make counselling easier, and will make it possible for more people to understand and follow the rules. Second, insofar as it will remove what is now a disagreement among the various federal circuits, and I am speaking about the Digidyne case now, passing this important bill will make it more possible to predict with accuracy what the rule is, or will be, in any particular instance.

Hewlett Packard's second comment with respect to this bill is that we seek to eliminate the harmful consequences of the Digidyne - Data General decision; and we support the bill's application of Rule of Reason antitrust analysis to our decisions whether to bundle or unbundle our various product offerings. This has significant implications for HP, both with respect to the antitrust counselling perspective and with respect to other issues as well. We believe that the ripples of the Digidyne decision are now being felt by HP and in the industry in general in areas which were never contemplated in the original decision.

One of those areas in particular directly impacts HP, and I would like to discuss that area with you today.

The factories to which I am attached manufacture medical products. The arrhythmia monitor I have brought here today is one of them. It is manufactured and designed at our Waltham Division in Waltham, Massachusetts. An arrhythmia is an abnormal heart rhythm. Patients whose hearts are experiencing arrhythmias can be connected to the monitor via two or three electrodes on the chest. The monitor then analyzes each heartbeat, signalling when the heart is beating too fast, too slow, or when one of the other abnormal patterns such as a fibrillation appears.

Now, the monitor, as you might have guessed, is really a special purpose computer. It has hardware, and software. The software is composed of operating software and applications software. I have had the chips on which the software resides marked with a special color. It is of no consequence that the software resides in a chip: it could equally reside on a strip of tape or a spinning disc of one kind or another. It is not really all that different from the Data General Nova computers of 1977 to 1980 which are the subject of the case which brings us here today.

HP has chosen to protect the software programs on this chip with copyright protection. What the Digidyne case tells us is that the minute we put that little "Circle-C" on the chip and in the program itself, we are presumed to have economic power from the program. "Economic power" is a legal term which brings about the result that our decisions to bundle the software with the hardware (tie in antitrust terms) can be considered "per se" violations of the antitrust laws.

Our choice, under Digidyne, is whether to protect the software and be judged by the per se rule, or to abandon it to the public domain and avoid the per se test.

Now we clearly do not want to abandon the software. Like our other high-technology competitors, some of whom are here today, we need to have an opportunity to recoup the investment of time and money made in developing the product. If we were to put the program into the public domain, we would in effect lose that opportunity.

The alternative under Digidyne -- to protect the software with a copyright and then unbundle it -- is equally undesirable. Let me explain:

With respect to the operation of our products, we design, build, test, obtain regulatory approvals, manufacture and sell them ourselves. This is not unique to HP, but appears throughout our industry. As an industry, we each do the best we can, and the members of the medical equipment industry are for the most part willing to stand up and be counted if there is anything which goes wrong. HP for one, takes great care to build its products to the highest standards, and we fix them if there is anything wrong. Our recent corporate-wide emphasis on total quality control (TQC) is a case in point.

I am sure you have all heard about the recent explosion in products liability litigation and medical malpractice litigation. Virtually all health care and medical equipment providers, including HP, have been affected. Hewlett Packard's philosophy, if you will, with respect to this trend, is to continue to emphasize quality in everything we do.

How does the Digidyne holding affect us? Well, as I

understand the opinion, it says that a manufacturer of hardware and software who elects to protect the software with copyright (like HP and like Data General) must unbundle or separate these portions of its products from each other and be willing to sell its software to competing hardware manufacturers for incorporation into their boxes. It says that we have to sell our software to run in our competitors' hardware boxes. This is something HP does not want to do. There are several reasons why:

1-First, we risk the loss of control of the quality of the final product. In the case of the arrhythmia monitor I spoke about before, the results of a missed arrhythmia can be immediate and dramatic.

2-Second, we may be forced to make future software compatible with both our and the other fellow's hardware. A complex and expensive undertaking.

3-And, third, we dramatically increase our exposure to products liability litigation. As the chance that something will go wrong increases, so does our exposure. It is of little or no comfort that there is another defendant in the case, the hardware manufacturer. The reality of the situation is that, with joint and several liability; with charitable immunity often available which protects the hospital defendant; insurance policy limits which serve to insulate the professional defendants, we the senior manufacturers are the only deep pocket remaining in the case. Our liability, including liability for the errors of our unwelcome hardware partner can be without practical limit.

4-Finally, we may be required to perform maintenance service on our competitors' equipment; to do otherwise in a coronary care environment would not be a realistic option.

Hewlett Packard (along with many of our legitimate competitors) is willing to stand up and be counted with respect to the quality of our products. The outcome of the Digidyne decision is that we must also stand up and be counted with respect to the quality of other people's products as well.

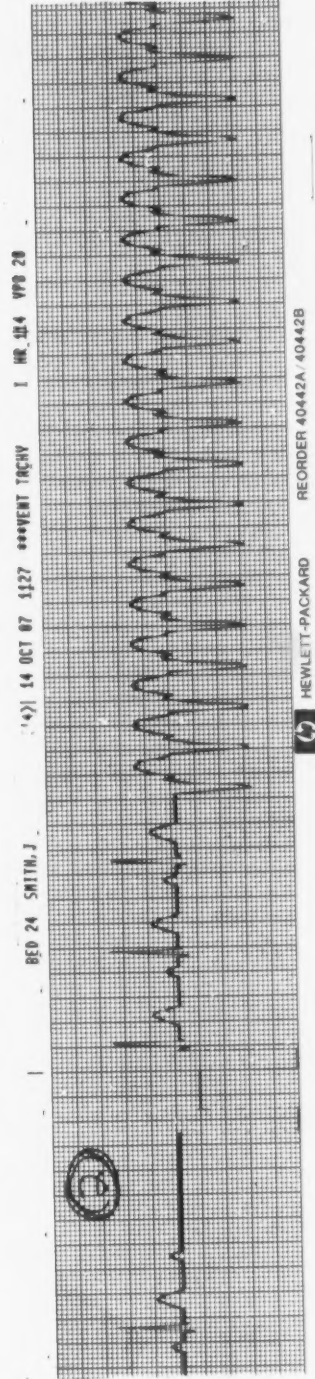
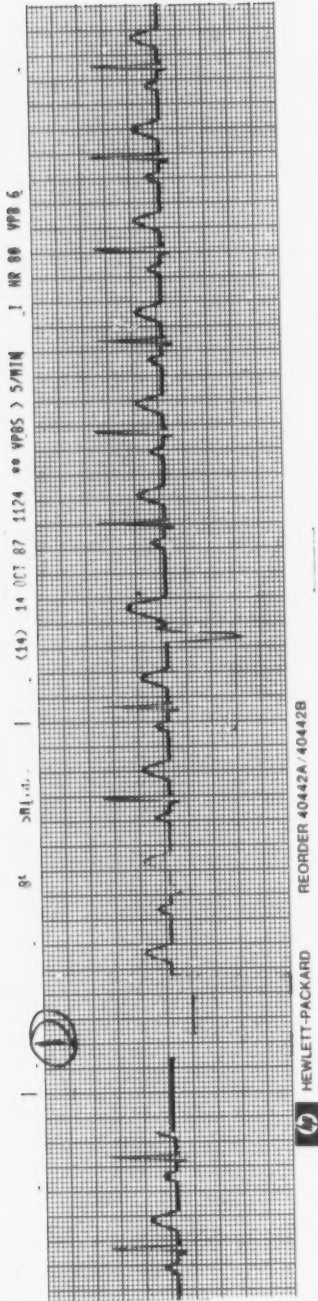
Now I don't want to leave you with the opinion that our desire to limit our product liability exposure is the reason I have come here. Behind each product liability lawsuit there is generally an injury or death. The increase in product liability exposure which I forecast if Digidyne is to be the law of the land is premised upon the increase in incidents which will be the natural result of the difficulty of making our software with various and different hardware and the attendant increase in complexity which accompanies it. Digidyne could, at least in the medical products industry, increase the patients' risk in any situation in which a computer controlled medical device is responsible for any significant part of the medical care of any of us.

As I hope I have made clear, high technology products are extremely complex to build and maintain in the most simple case. Adding required unbundling can only add an additional level of complexity to this task, resulting in a loss of competitiveness, quality and price performance, and ultimately adversely affecting the patient.

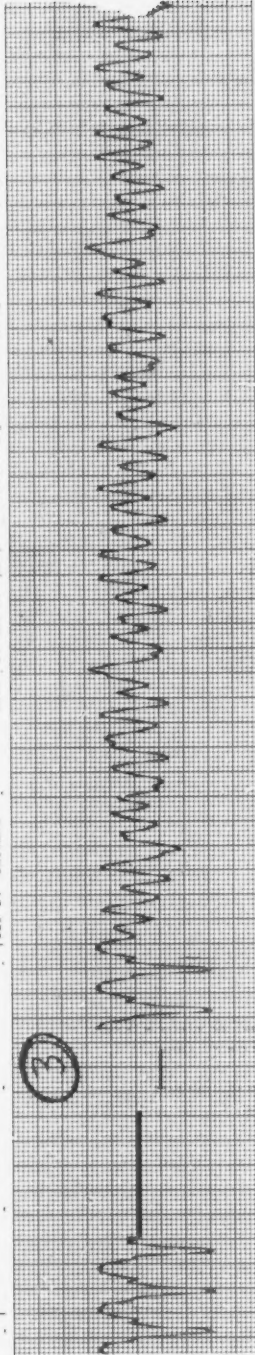
For these reasons, HP supports the bill which is before the committee today.

I have supplied the committee with copies of this statement, and request that they be made part of the record.

HEWLETT PACKARD
HEART MONITOR TAPE

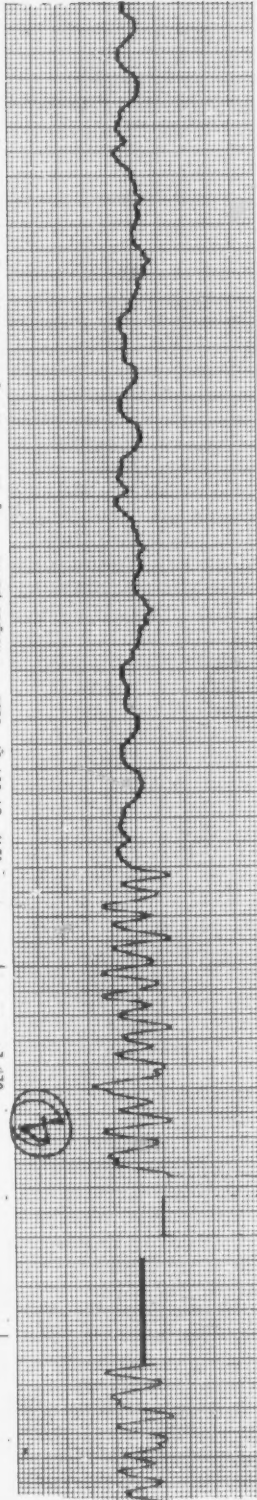


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HEWLETT-PACKARD REORDER 40442A/40442B

Senator LEAHY. Thank you very much.

I will have some questions, but why don't we go to Professor Shapiro first, and we may end up having questions that both of you will want to take a crack at answering.

I welcome Senator DeConcini.

Senator DECONCINI. I do not have any statement. Thank you, Mr. Chairman.

Senator LEAHY. Thank you.

Professor Shapiro?

STATEMENT OF CARL SHAPIRO

Professor SHAPIRO. Thank you. I appreciate the opportunity to appear before you today.

I have done some research over the past several years in the area of technology licensing, and on the basis of that research, I also support application of the rule of reason to the licensing of intellectual property, believing that would serve a very useful role in promoting the development of innovations and in making these discoveries more widely available.

I do have reservations about the detrebling aspect part of the bill, however, and I will get to that.

Let me ask you to shift gears from the very concrete application you have just seen to give me an opportunity to discuss more generally the role in the economic system of the licensing of intellectual property.

The starting point for that analysis is to ask yourself what is so special about intellectual property that it deserves treatment any different from other property. And the answer is that it is very difficult to protect intellectual property. As has just been mentioned, innovators are concerned about their property being copied, imitated, and of course, it is much easier to imitate one of these chips than it is to get hold of someone's physical property.

When a company builds a factory, they do not need to worry about a competitor spiriting it off for its own use, but intellectual property is more difficult to protect.

So that is why, of course, we have the patent system and the copyright system, to reward inventors. But there is a natural tension in that in so rewarding them, it may not actually help promote the widespread use of the innovation or what economists call "diffusion." So there is a tension between rewarding innovation, which is what the patent system does, and getting innovations widely spread so that they are used in many applications.

Since the whole point of the patent system is to reward inventors, it is dubious at best to then turn around and penalize an inventor simply because of the patent; and this presumption of market power on the basis of a patent does exactly that, particularly hurting the small inventor, who is going to rely on licensing in order to get a return on the R&D expenses.

I think the dangers of placing limitations on the licensing of intellectual property are especially marked in today's environment, with stiffened international competition, which makes imitation and competition from rival technologies all the more likely. Particularly in the high-tech industries where the pace of technologi-

cal progress is so rapid, it is important for innovators to be able to recoup their investment quite rapidly, the the patent system, or even a long-lived patent may not be able to do that, and allowing a freer hand in the licensing of intellectual property can serve that function.

Licensing, what is so special about it is that it not only promotes innovation by allowing the inventor to recoup the R&D costs, but it also promotes the diffusion, the widespread use. The licensees are using the innovation, and that is economically efficient.

So there are substantial benefits associated with licensing. Of course, it is not just licensing, but the restrictions in licensing agreements that are really at the heart of the issue here—the restrictions on tying conditions in particular—and so there is a legitimate antitrust concern that these restrictions, do they in fact promote the wide-spread use of the invention.

Some restrictions are in and of themselves procompetitive, as the example of a tying restriction that is designed for quality control, and these, we certainly want to permit in the antitrust arena. Other restrictions are not in and of themselves desirable, but they serve a useful function in rewarding innovation, just as does the patent. The patent system rewards innovation with monopoly power. We accept a necessary evil in order to promote important good, namely, technological progress.

So all of this says that for licensing agreements, and even restrictions on them, there are pluses and minuses, and the courts should take these into account. That is all applying the rule of reason is doing. I would not be in favor of any exemption, but just requiring the court to recognize the possible many benefits associated with licensing agreements and some of these restrictive practices serve potentially useful purposes.

I think that does not apply when we are talking about a price-fixing agreement, which is the area where the per se rule still should apply, and I see that Congressman Fish has addressed that concern, that the legislation not be too broad. We do not want to remove the per se rule as applied to price-fixing.

Lastly, on the detrebling provision, I do not see why, if the court applies the proper rule of reason approach and determines that a licensing restriction is in fact anticompetitive, I do not see why reduced damages would be appropriate. The role of treble damages is to provide deterrence, to prevent these anticompetitive practices, and if in fact practices are ruled anticompetitive under a careful rule of reason analysis, I think the treble damages should be assessed.

[Statement of Professor Shapiro follows:]

Testimony of Carl Shapiro
 Professor of Economics and Public Affairs
 Princeton University
 October 20, 1987

Good morning. My name is Carl Shapiro. I am a Professor of Economics and Public Affairs at Princeton University. In the past several years, I have explored the economic effects of technology licensing.¹ On the basis of that research, I believe that applying a rule of reason to the licensing of intellectual property would serve a valuable role in promoting both the development and diffusion of innovations. I have some serious reservations, however, regarding the proposal to de-treble damages in all cases involving the licensing of intellectual property.

Intellectual Property Deserves Favorable Antitrust Treatment

The starting point for my analysis of licensing is the recognition that intellectual property is fundamentally different from other types of property: it is harder to protect works of the intellect than it is to protect other forms of property. A company that builds a new factory need not worry that a competitor will spirit the facility off for its own use.

¹ C. Shapiro, "Patent Licensing and R&D Rivalry," *American Economic Review*, May 1985; M. Katz and C. Shapiro, "On the Licensing of Innovations," *Rand Journal of Economics*, Winter 1985; M. Katz and C. Shapiro, "How to License Intangible Property," *Quarterly Journal of Economics*, August 1986; M. Katz and C. Shapiro, "R&D Rivalry with Licensing or Imitation," *American Economic Review*, June 1987.

But the firm that develops a new product or process must be wary indeed of competitors seeking to copy its invention without themselves incurring the costs of research and development. Inventors perennially are threatened with imitation, with the theft of trade secrets or industrial know-how, and with the loss of proprietary information carried away by former employees. In other words, inventors find it difficult to appropriate the fruits of their research and development efforts.²

The unique feature of intellectual property can be described succinctly: many parties can easily make use of the same invention, quite possibly including parties that had no hand in its development. This observation has two related implications for patent and antitrust policy: (1) rewarding inventors with property rights is essential if innovation is to be encouraged, and (2) once an invention has been discovered, efficiency calls for it to be widely used.³ Innovation and diffusion are each crucial components of technological progress.

In many cases, there is a conflict between the twin goals of innovation and diffusion. For example, when a patentee requires a licensee to purchase a tied product along with the

² For a summary of some recent survey results indicating that managers regard the protection of intellectual property as rather weak, see R. Levin, "A New Look at the Patent System," *American Economic Review*, May 1986.

³ This last assertion follows from the low social cost of allowing an additional party to use the invention.

license, this restriction promotes invention but, by increasing the patentee's monopoly power, may retard diffusion. The very idea of the patent system⁴ is that we accept a necessary evil - some degree of monopoly power - in exchange for an important good - the promotion of innovation.

Since the *raison d'etre* for the patent system is to offer some monopoly power as a reward, it makes little sense to then turn around and use antitrust policy to penalize the very parties we are trying to reward. For this reason, it is unwise for the courts to judge patentees on harsher terms than other defendants in antitrust cases. In tying cases, for example, it is dreadful public policy to presume the presence of significant market power (a key step in the *per se* rule against tying) merely from the existence of a patent. On the one hand, many patentees in fact face substantial competition from rival technologies, so they have little economics power. And, on the other hand, even when such power is present, the courts should realize that it is serving a useful function by rewarding innovation.

In fact, the need to promote innovation implies that antitrust law should treat monopoly power associated with patents more favorably than it does other forms of monopoly

⁴ For simplicity, I shall refer to "patents" even when I have in mind all forms of intellectual property.

power.⁵ Antitrust policy especially should bow to patent policy in circumstances where patent protection is unavoidably weak, as when imitation is difficult to prevent. Doing so helps correct for the imperfect protection provided by the patent system itself.

The tension between patent policy and antitrust policy is equally one between long run and short run objectives. In the long run, technological progress is crucial to continuing economic vitality, innovative incentives are paramount, and broad protections for intellectual property rights appear attractive. In the short run, limiting the monopoly power attached to existing innovations may take precedence, calling for a vigilant antitrust policy.

Thus, if one believes that the current incentives for American firms to undertake R&D are adequate, and that the dangers associated with patent monopolies are great, one is unlikely to support the current legislation. Conversely, if one believes, as I do, that it is important to further promote R&D, that innovators have difficulty protecting their discoveries, and that many patentees face substantial competition from rival technologies, a rule of reason approach

⁵ For a clear exposition of this general principle, see L. Kaplow, "The Patent-Antitrust Intersection: A Reappraisal," *Harvard Law Review*, June 1984. Of course, it is widely appreciated that market power derived from superior insight or foresight should not itself be subject to antitrust challenge.

to licensing cases is clearly a step in the right direction.⁶

This need for increased rewards for innovators is especially apparent in the context of stiffened international competition, which makes both imitation and competition with rival technologies all the more likely. Allowing patentees wider latitude in exploiting their discoveries also is appropriate today in the so-called "high-tech" industries where the pace of technological progress is especially rapid. In these industries, an innovator must recoup his or her investment quite rapidly, before it becomes obsolete. No matter how long-lived, a restricted patent or copyright grant may give insufficient innovative incentives. Software developers, for example, have a relatively brief period of time during which to recoup their development costs before their product is eclipsed by a new generation of programs.

Licensing can Promote Both Innovation and Diffusion

An especially strong case can be made for favorable antitrust treatment of licensing. What is so special about the licensing of intellectual property is that it can simultaneously promote both invention and diffusion. The opportunity to engage in licensing clearly enhances the value of a patent, thereby promoting innovation. And licensing

⁶ Unfortunately, we have no good measure of the relationship between the rewards to innovation and the pace of technological advance. Can anyone be sure that the optimal patent lifetime is not nineteen, rather than seventeen, years?

itself is a form of diffusion, a way of allowing more parties to take advantage of the invention. Because of its ability to promote both invention and diffusion, licensing - like cooperative research - deserves especially lenient antitrust treatment.

When firms do issue licenses, there are substantial benefits, both private and public. But the licensing of technological property is hampered by natural market imperfections in the market for intellectual property. In particular, (1) any license naturally creates a danger that the invention will be imitated, and (2) it is difficult to market licenses unless the licensees fully appreciate the benefits of the invention, in which case they may know enough to copy it. To the extent that antitrust policy imposes legal obstacles on licensing, it exacerbates these two existing market imperfections, further hampering the diffusion of new technologies.

Unfortunately, while licensing itself promotes diffusion, restrictions on licensees' behavior - such as tying requirements, price-restricted licenses, or territorial restrictions on licensees - do not. So, there is a legitimate antitrust concern with restrictive clauses attached to license agreements. This concern is especially evident when a licensing arrangement might promote collusion, a danger most likely to arise with cross-licenses between direct competitors and where price-restricted licenses are involved.

As real as these antitrust dangers are, I believe it is unwise and inappropriate to apply a per se rule to restrictions in licensing contracts. A per se rule makes sense only with regard to activities that are judged to be undesirable in the overwhelming majority of cases. This characterization is inaccurate when it comes to any legitimate licensing agreement. There are two pro-competitive effects of any restriction in such an agreement: (1) the restriction, if sought by the patentee, must necessarily raise the value of the patent, thereby promoting innovation, and (2) the restriction may in fact promote diffusion, since the patentee might choose not to license at all if the restriction were deemed illegal.⁷

When the ancillary restraints attached to a licensing agreement are in and of themselves anticompetitive, the courts must balance their undesirable effects against their beneficial role in promoting innovation. And the court might well inquire into whether a less restrictive arrangement would have served the patentee's legitimate goals (e.g., quality control) equally well. But this type of inquiry is exactly what the rule of reason calls for. The per se rule is simply inappropriate for judging genuine licensing agreements.

⁷ In our paper "On the Licensing of Innovations," *Rand Journal of Economics*, Winter 1985, Michael Katz and I show how a patentee can be deterred from licensing at all if there are constraints on the patentee's use of per-unit royalty rates.

Price-Fixing and Sham Licenses

The only situation where a per se rule makes sense in the context of licensing is if the license is really a "sham," being used as a cover for a price-fixing scheme. This danger is most marked if price-restricted licenses are involved, or in a case involving cross-licensing between direct rivals. In the case of a sham licensing agreement, the rewards from price fixing are not based upon the true value of the invention that is being licensed, and diffusion is not served by the license.

Concerns have been raised that the proposed legislation might allow price fixers to hide behind the shield of a patent license. This concern is a legitimate one, and it is important that the Congress make clear that its intent is not to change the per se illegality of price fixing, even though the price fixing might nominally be part of a technology licensing agreement. I am optimistic that sham licenses, or any licensing agreements whose primary purpose is to increase prices rather than to disseminate technological know-how, can in fact be detected by the courts and subjected to the usual per se rule.⁸ If necessary, price fixing under the guise of a technology license could be detected and struck down as a separate agreement to which the current legislation does not apply. Those who oppose the bill because it will allow price

⁸ Even if a rule of reason were applied, the court would rapidly detect a sham license and rule against it, just as the court now distinguishes between agreements whose primary purpose is to fix prices and those that control prices as part of a larger purpose.

fixing take too dim a view of what the courts can do.

Single vs. Treble Damages

The case for adopting a rule of reason in evaluating all genuine licensing agreements is strong. But I regard the arguments for de-trebling damages associated with licensing as much weaker.

Suppose that the court conducts a full rule-of-reason inquiry into a restrictive licensing practice such as tying or a territorial restriction. And suppose that the court finds that the practice has indeed been anticompetitive. Why should the damages be smaller just because intellectual property was involved?

One might argue for smaller damages by pointing out the importance of preserving incentives to innovate, or the benefits of reducing the antitrust risks faced by patentees. But these incentives can more appropriately be accounted for under the rule of reason - by adopting the lenient antitrust treatment of intellectual property that I advocated above. Under the rule of reason, the patentee can argue that a given practice was a legitimate extension of the patent grant, and the court should account for the genuine social benefits associated with enhancing the value of the patent. If, after properly accounting for the legitimate property rights of a patentee to exploit the patent grant, the court rules that a certain practice was still anticompetitive, I see no reason why

the usual treble damages provision should not apply.

The main purpose of treble damages is to serve a role in deterring anticompetitive behavior. As is well known from the theory of optimal enforcement policy, if enforcement is imperfect, the punishment should be greater than the damages. The smaller the probability of detection and punishment, the larger must the penalty be. Detrebling damages would eviscerate the deterrence value of antitrust law. If the aim of the detrebling provision is to diminish plaintiffs' incentive to sue, the superior approach is to de-couple damages: to assess the defendant with treble damages, of which one third would be awarded to the plaintiff and the rest collected as a fine.

Summary

Intellectual property deserves especially favorable treatment under the antitrust laws, especially as regards the licensing of such property. Licensing raises the reward to innovation, and can promote diffusion of innovations. Although restrictive licensing practices can indeed harm competition, they offer sufficient potential benefits - at least when the license is more than an excuse for price fixing - that they warrant a rule of reason analysis before being condemned on antitrust grounds.

Senator LEAHY. Let me ask you to summarize how you see the threat of per se antitrust liability inhibiting innovators from developing and marketing their ideas.

Professor SHAPIRO. Well, an important part of the return to innovation, to the way innovators recover their cost, is through licensing. And if they are afraid that in the natural course of marketing their product, their intellectual property, they are going to be struck down without a careful review, that could seriously stifle innovation.

Senator LEAHY. Well, do you criticize the rule by which courts in tying cases presume market power from the existence of a patent or a copyright? Does a patent or a copyright by itself actually represent economic or monopoly power?

Professor SHAPIRO. Not in the sense that the courts use the term. The value of a patent is that it protects a unique idea, and we want to reward innovation in that way. But that does not give monopoly power in the sense that the courts would then presume illegality.

Senator LEAHY. Then, in those antitrust cases, should the courts determine whether a defendant has market power rather than just presume it from the existence of a patent or a copyright?

Professor SHAPIRO. Absolutely, yes.

Senator LEAHY. Would you agree with that, Mr. Feman?

Mr. FEMAN. Yes, yes, Senator, we would. A patent license or a copyright license in a product that has no commercial value certainly is not one that gives the owner or the licensee any kind of economic power in anything but a theoretical or abstract sense.

Senator LEAHY. Do you think it is probably time for reality to intrude on the theory?

Mr. FEMAN. Yes, sir.

Senator LEAHY. That is about it. Gosh, I am glad to hear that. Go ahead.

Mr. FEMAN. I would like to share with the committee my experience. From time to time, I have taken a marketing manager or a marketing professional to visit the outside antitrust lawyer to review a new marketing scheme, especially in medical products, where the health care providers now are grouping together to form groups for the purpose of purchasing; how a manufacturer responds to the presence of a large group. You do that by creating a marketing plan, and how are you going to sell and how are you going to discount, to which groups.

So I have on a number of occasions taken marketing professionals to see the antitrust lawyer. And on those occasions where a particularly unrealistic—if you will excuse my expression or use of the word—antitrust law comes into play, the marketing professional usually walks out of the room very unhappy. It is not just that the rule is counterintuitive; it is often that the rule that we ask them to follow is hard to swallow, almost ridiculous. We are going to tell them, for example, that the software and the hardware on this board should be treated by the courts like a mattress and a bed—you have to be able to sell one without the other. That would be hard to swallow.

In those cases where the marketing scheme is analyzed by a rule of reason, however, it is possible for the lawyer and the client to

communicate. It is possible to speak in terms of market reality and in terms of what the real effect on competition would be.

I think the rule of reason is like a breath of fresh air in this world where lawyers like myself are asked to explain recently made laws, explain laws to people which really have little relation to practical reality.

Senator LEAHY. Let me see if I understand, now. You sell the heart monitor separately from the software, or do you sell the two together?

Mr. FEMAN. We sell the two together.

Senator LEAHY. And how does this legislation affect your future marketing policy?

Mr. FEMAN. Well, it will affect us in that it will endorse this marketing practice as one which we think we can defend under a rule of reason, and we don't think under the rule of reason we could be forced to unbundle the software from the hardware.

However, if we were brought into court merely to argue that we do not have so-called "economic power" in the software, that might be a little more difficult to prove or to rebut.

Senator LEAHY. Thank you.

Senator DeConcini?

Senator DeCONCINI. I have no questions, Mr. Chairman, thank you.

I have questions of the ABA witness and of Mr. Brown when he is before us, and I have to leave in a few minutes, so I am going to ask if the chairman would submit those questions for me at the appropriate time.

Senator LEAHY. I will do that.

Senator Thurmond?

Senator THURMOND. Thank you, Mr. Chairman.

Mr. Shapiro, some have argued against inclusion of trade secrets within the coverage of S. 438. What are the advantages or disadvantages of including trade secrets?

Professor SHAPIRO. First off, it is difficult to license trade secrets to begin with, because you will lose secrecy. So there is already a natural obstacle in the market for licensing of trade secrets. A further obstacle presented by the antitrust laws would exacerbate that existing problem.

Senator THURMOND. Although you argue against detrebling damages, I believe—

Professor SHAPIRO. Yes.

Senator THURMOND [continuing]. Are there situations in which the possibility of treble damages would inhibit the legitimate activities of a licensor as much as the per se rule?

Professor SHAPIRO. Well, the legitimate activities of a licensor would not be ruled illegal under the rule of reason, so treble damages would not be applied.

Senator THURMOND. I think those are all the questions I have, Mr. Chairman. Thank you.

Senator LEAHY. Thank you very much, Senator Thurmond.

Senator Metzenbaum?

Senator METZENBAUM. What is unique about the piece of equipment that you are showing us here today?

Mr. FEMAN. As I explained a little earlier, the box here that is directly in front of me sits by the bedside and merely displays the wave from as it comes out of the patient, if you will.

The box on your right, which sits at a central station, analyzes each heartbeat and determines whether or not it is a normal beat or an arrhythmia, which is a nonrhythmic beat. The method it uses to do that, the algorithm, the series of measurements it takes and applies to the beats, is something that we developed at our company over the last 15 years; we believe it is very unique and very good.

There are virtually no false negative alarms, which means it very seldom, if ever, misses a dangerous situation. And the other side of the coin is the reduction in false positives, which is an alarm that alarms when nothing is wrong. That is like when the burglar alarm goes off in a car on the street, and no one is trying to break into the car. So we try to reduce the number of false positives, and this has a very good rate of both, rejection of both false alarms, and that is what makes it unique, Senator.

Senator METZENBAUM. Well, first, I would commend your company for the advancements you have made, and I know what has gone on in this area, although not nearly as well as you people know it, because that is your field. But this bill proposes two drastic changes in the way the antitrust laws are applied to agreements to convey rights to intellectual property—detrebling and the elimination of all per se illegality.

Now, as I read the bill, its coverage is very broad. It seems that it would apply to price-fixing agreements, horizontal market allocations, tying arrangements, among other things.

What conduct which is currently per se illegal under the antitrust laws would be covered by this bill?

I guess the problem I am having is, I pay respect to you for your innovative genius that is at the company for the creation of this new equipment and others as well, but I have two problems. One is how does eliminating treble damages help you competitively; and second, what are you trying to be permitted to do that you cannot presently do under the antitrust laws of our country?

I am having trouble—you see, every day of the week, some well-intentioned Senator—some not-so-well-intentioned Senators, as well—comes along with a proposal to provide an exemption from the antitrust laws. So I have a knee-jerk reaction to providing exemptions.

Senator DECONCINI. Yes, you do.

Senator METZENBAUM. When my friend over here wants to provide an exemption for the beer industry, I say, "Yes, but that is what I said you people were going to do when you provided an exemption for the bottlers' industry."

And everybody—

Senator LEAHY. That is not the issue today, though.

Senator METZENBAUM. Well, I know beer is not the issue today, but everybody has a violin quartet standing behind them, telling us how it will help America's competitiveness if we will just provide an exemption for them from the antitrust laws.

So in language that I can understand, tell me why you need to be here, why you need this legislation.

Mr. FEMAN. I will try to answer your question.

Senator LEAHY. Go ahead, Mr. Feman, and Professor Shapiro, if you want to follow up afterward, too, you may.

Mr. FEMAN. First of all, we are not here today asking that the price-fixing or horizontal market allocation rules be changed. We do believe that the per se rule should apply in those circumstances. And if you read the language of the act to change that, we would support an amendment, a language amendment, to clarify that. And I understand that clarifying language has been or will be submitted on those points.

With respect to tying, I think we need to be here today because in the Ninth Circuit Court of Appeals, a rule occurred which we read to say that there is a very hard to rebut—rebuttable, but hard to rebut—presumption that the minute that we put a little copyright notice on these chips, we are forced to offer it to sale to anyone who comes along. We think that would be bad for competition, bad for health care providers, bad for health care recipients, and bad for manufacturers.

So we are here in particular with respect to the example I brought to you today, to ask that the presumption of market power that arises from copyright or patent protection be tempered by the rule of reason and that we be allowed to bring before a court the reasons—the real rules. We should not be just brought into court and told, “The only thing you can do here, Mr. Defendant, is rebut a hard to rebut presumption that you have market power because you chose to put a copyright notice on that software.”

We would like to be able to say what is good about putting a copyright notice on that software, and I think that the things I said today make it clear that in this case it would be wrong to require us to unbundle these chips from the rest of the system.

Senator METZENBAUM. I think that is logical.

Senator DECONCINI. Well, Mr. Chairman—if the Senator would yield—

Senator METZENBAUM. Certainly.

Senator DECONCINI. That is, I think, a very logical answer, and I think it is just important for the record to show that you are not asking for an exemption from antitrust, nor is the beer bill, nor did the soft drinks bill. What you are asking for is a different standard to be applied. Isn't that really what we are talking about?

Now, to some, that may be a substantial deterioration of the whole “protection” of the antitrust laws. But you are not really asking for an exemption here, are you?

Mr. FEMAN. I believe that is correct. We are not.

Senator DECONCINI. Thank you.

Senator LEAHY. I would note on this, Howard—and it is in my opening statement—the bill is not going to exempt any conduct from the antitrust laws. It is only going to make illegal those agreements that are actually anticompetitive.

Senator METZENBAUM. Mr. Chairman, would you explain why you change the treble-damage provision to a single-damage provision, and how that relates to this issue?

Senator LEAHY. Because if the intellectual property agreements are not per se anticompetitive, then I do not see them as having the kind of automatic antitrust restrictions that anticompetitive

agreements have, and in that case, they should be limited to actual damages and attorney fees, plus interest, of course.

I see it as being a different thing where we are dealing with, as the witnesses said here earlier this morning, the rule of reason, not a per se rule. I see little need to have the treble damages apply to these intellectual property agreements. I think we are stepping out of that. And I think also that with regard to such intellectual property agreements the threat of treble damages itself has probably been anticompetitive, in an era where you are going to need this kind of technology if you are going to be able to compete.

Well, that is a subject that we could discuss as the legislation moves along.

Are there any other questions of these gentlemen?

Professor Shapiro, did you want to add anything to that answer earlier, or are you happy with it?

Professor SHAPIRO. Well, I would just respond very briefly to Senator Metzenbaum's question. There are a variety of beneficial effects of licensing that help consumers. I believe you are quite concerned about—

Senator METZENBAUM. I did not hear that. Say that again, please.

Professor SHAPIRO. There are a variety of beneficial effects of licensing that are in the interest of consumers, and some of these desirable licensing arrangements, such as that described here, are being prohibited under the current treatment of the law. That is what the bill would aim to change.

Senator METZENBAUM. Well, I do not have any quarrel with the idea of licensing, which I consider to be a legitimate business operation. I think that's how it falls with respect to the antitrust implications is of concern to me. We will take another look at the problem.

I will at this time, Mr. Chairman, put my entire opening statement in the record. I appreciate your comment, Professor Shapiro.
[Statement follows:]

OPENING STATEMENT OF SENATOR HOWARD M. METZENBAUM
CONCERNING S. 438

THIS HEARING IS ABOUT YET ANOTHER BILL OFFERED IN THE NAME OF IMPROVING OUR INTERNATIONAL COMPETITIVENESS. I HAVE VERY SERIOUS DOUBTS ABOUT WHETHER THE BILL WOULD ACCOMPLISH ITS STATED GOAL. IN FACT, I AM CONCERNED THAT THE BILL, INSTEAD, WOULD GIVE A BOOST TO OUR STIFFEST FOREIGN COMPETITION.

THE BILL WOULD PROVIDE SPECIAL, RELAXED TREATMENT UNDER THE ANTITRUST LAWS FOR AGREEMENTS CONVEYING RIGHTS TO CERTAIN INTELLECTUAL PROPERTY. UNDER THE BILL, PRICE-FIXING AGREEMENTS, HORIZONTAL MARKET ALLOCATIONS, AND TYING ARRANGEMENTS WHICH ARE NOW ABSOLUTELY CONDEMNED, WOULD BE SUBJECTED TO LESS ANTITRUST SCRUTINY. EVEN IF A GIVEN AGREEMENT WERE STILL ILLEGAL UNDER THIS RELAXED STANDARD, THE INJURED PLAINTIFF WOULD BE UNABLE TO RECOVER THE NORMAL ANTITRUST AWARD OF TREBLE DAMAGES. INSTEAD, IT COULD RECOVER ONLY ACTUAL DAMAGES, PLUS INTEREST.

LET'S TAKE A LOOK AT HOW THIS BILL MIGHT AFFECT OUR INTERNATIONAL COMPETITIVENESS.

ACCORDING TO THE MOST RECENT ANNUAL REPORT OF THE PATENT AND TRADEMARK OFFICE, 42,387 PATENTS WERE ISSUED TO RESIDENTS OF THE UNITED STATES IN 1986. DURING THAT SAME PERIOD, 34,606 PATENTS WERE ISSUED TO RESIDENTS OF FOREIGN COUNTRIES. THUS, ALMOST 45% OF ALL PATENTS WERE ISSUED TO FOREIGNERS LAST YEAR.

RELAXATION OF THE ANTITRUST LAWS RELATING TO INTELLECTUAL PROPERTY, THEREFORE, WOULD AFFECT OUR FOREIGN COMPETITORS JUST ABOUT AS MUCH AS IT WOULD AFFECT AMERICANS. IT'S HARD TO IMAGINE HOW THESE FIGURES WOULD TRANSLATE INTO A "PLUS" FOR OUR INTERNATIONAL COMPETITIVENESS.

MY CONCERNS GO BEYOND THE ISSUE OF INTERNATIONAL COMPETITIVENESS, HOWEVER. I AM CONCERNED THAT S. 438 WOULD HAVE AN ADVERSE IMPACT ON SMALL HIGH TECHNOLOGY COMPANIES AS WELL AS INDIVIDUAL ENTREPRENEURS AND INVENTORS. I AM ALSO CONCERNED THAT PASSAGE OF S. 438 WOULD LEAD TO PRESSURE ON CONGRESS TO PASS

SIMILAR ANTITRUST EXEMPTIONS FOR OTHER SPECIAL INTERESTS. TO DATE, I AM NOT CONVINCED THAT THERE IS A NEED TO RELAX APPLICATION OF THE ANTITRUST LAWS FOR THIS INDUSTRY, PARTICULARLY WHEN THE EXEMPTION MIGHT APPLY RETROACTIVELY. I HOPE THAT THE HEARING TODAY WILL ADDRESS THESE ISSUES.

I LOOK FORWARD TO RECEIVING THE TESTIMONY OF THE WITNESSES AND WORKING WITH MY COLLEAGUES ON THE TECHNOLOGY AND THE LAW SUBCOMMITTEE.

Senator LEAHY. Mr. Feman?

Mr. FEMAN. If I could add, the answer to Senator Metzenbaum's other question about treble damages, from Hewlett-Packard's point of view. The particular behavior which is prohibited which we seek to keep under the per se rule, the horizontal price-fixing and horizontal market allocation, those are arrangements which can be entered into by parties in smoke-filled rooms, the typical smoke-filled room, or in private, in secret. And the way, over the past years, that that behavior has been stopped, if you will, is through, yes, treble damages, but in practical terms it has been brought about because lawyers are now present at trade association meetings where it is possible to discuss price. Just by bringing lawyers into the picture, you have brought about a cleaner arena, and less of that behavior goes on.

I think that as far as licensing of intellectual property is concerned, lawyers are already involved. It is virtually impossible to enter into a software license or a patent license without having a lawyer there, or two lawyers, or three. It is such complex stuff, the intellectual property. Most people do not know what it is. They still talk about selling their patent when they mean licensing it and selling their copyright when they mean licensing it.

You cannot do it. You cannot enter into this agreement in the first place unless you have lawyers there. And the fact that lawyers are there means you are going to have much less illegal behavior.

So it is a different animal than price-fixing and market allocation, things that can be brought about where you can do without lawyers.

Senator METZENBAUM. You do not think lawyers would ever be a party to price-fixing?

Mr. FEMAN. Well, I do not mean to imply that all members of the bar are honorable—

Senator METZENBAUM. I am not even saying they are dishonorable. I think that they just try to figure out a way to make possible that which their clients want them to do, and that is really part of the practice of law.

Mr. FEMAN. For these 10 years that I have been doing this, I have been in lots of negotiations with large companies and with small companies, with companies that had lawyers and companies

that did not have lawyers, and I have never in the entire 10 years been in a circumstance—and the lawyer always tries to accomplish what the client wants. But once the rule is put on the table, once someone says, "What you are asking us to do, we cannot do, because it is prohibited by this case or that case, or this rule or that rule," generally, that is the end of it, that is the end of it. It just stops. So I think you do not need treble damages in intellectual property licensing like you do in horizontal price-fixing and market allocation.

Senator METZENBAUM. Mr. Feman, do you think if we had passed this bill yesterday, Hewlett-Packard would not have lost as much in the market yesterday? [Laughter.]

Senator LEAHY. Thank you very much, gentlemen. We will probably have other questions for the record. We appreciate your being here.

Senator THURMOND, did you have further questions?

Senator THURMOND. No, Mr. Chairman, I have no questions. I just want to ask unanimous consent that my statement be inserted into the record.

Senator LEAHY. Of course.

[Statement of Senator Thurmond and questions and answers of panel, subsequently received for the record, follow:]

PREPARED STATEMENT OF HON. STROM THURMOND, A U.S. SENATOR
FROM THE STATE OF SOUTH CAROLINA

MR. CHAIRMAN:

I am pleased to be a co-sponsor of S. 438 with you and several other of our distinguished colleagues. This important legislation will apply the rule of reason to agreements concerning patents, trade secrets, and copyrights. It also limits relief to actual damages, rather than treble damages. Although there may be problems with S. 438 as it is currently drafted, I believe that the thrust of the bill is sound.

Under existing antitrust law, courts may find that terms and conditions of licensing agreements are per se illegal, and not allow any inquiry into possible competitive justifications. In my view, this situation creates a negative environment for research, development, and marketing of new technologies. By requiring the application of the rule of reason standard to licensing agreements, rather than the stricter per se standard, S. 438 will enhance the competitive environment of new technologies by encouraging the development and subsequent licensing of these technologies to others.

At the same time, S. 438 does not eliminate or weaken enforcement of antitrust laws as applied to licensing agreements. It simply requires the courts, in the context of an antitrust challenge to a licensing agreement, to utilize the rule of reason standard, and to fully examine the competitive justifications for the agreement.

There are those who argue that the coverage of this bill is too broad and that it provides for special treatment of intellectual property that can be accomplished in a far narrower way. I am willing to consider alternatives, and would hope that our witnesses here today will feel free to discuss whatever ideas they have for improving this bill.

Mr. Chairman, I look forward to the testimony of our witnesses and thank them for their time and effort in appearing here today.

RESPONSE OF SANFORD FEMAN
TO QUESTIONS FROM SENATOR LEAHY

1. If the rule of reason were the standard applied to most agreements conveying intellectual property rights, how would it affect firms in their decisions to invest in the research and development of new technology, or to market new technology?
1. Adoption of the rule of reason standard for agreements conveying intellectual property rights would remove multiple layers of uncertainty which current antitrust rules impose on the research and development planning process among experienced R&D investors.

Hewlett-Packard is an experienced R&D investor. Total corporate R&D expenses last year approximated \$900 million. All experienced R&D investors rely on previous experience with the patent, copyright, and trade secret laws in formulating business plans when new product developments are funded. Because of this, the ability to plan for and rely upon one's rights in newly developed intellectual property is an essential element in the R&D planning process and in achieving successful R&D results.

The law, in its present state, introduces multiple unnecessary elements of uncertainty into this planning process, and by doing so, makes it a great deal more difficult for an experienced R&D investor to plan its R&D accurately. Research is a more risky and therefore more expensive venture. Because of this, an R&D investor such as Hewlett-Packard is faced with the following questions, among others, in making investment decisions:

1-Will a protectable intellectual property right be perfected in some component of the new product?

2-If so, will we chose to market the component of the product which embodies the intellectual property right in conjunction with other product components?

3-If so, will a competitor arise, (and if so, when?) which seeks to market its product in conjunction with the protected component of our product?

An R&D investor must face these questions squarely and must predict their outcome accurately. When these three questions are answered in the affirmative, as they often are, then, under the law as it today exists, the R&D investor is placed squarely on the horns of the Digidyne dilemma. The choices are as follows:

Retain the intellectual property protection
but allow the sale of the component containing
the protected intellectual property right
unbundled, or,

Abandon the intellectual property right and
continue to sell the bundled system.

The reasons why a manufacturer would want to avoid the former alternative have been extensively described, in Hewlett-Packard's oral testimony and elsewhere. A choice of the latter alternative is to be avoided because it renders the intellectual property right worthless.

At a later stage in the life cycle of a new product, an additional level of uncertainty arises under today's laws. The R&D investor must respond appropriately in the event that a competitor should spring up who infringes the intellectual

property right. No matter how blatant or wrongful the infringement, the R&D investor now has one additional hard choice -- to sue or not to sue. This brings up another unfortunate dilemma:

The choice to not sue is undesirable, as above, since it constitutes virtual abandonment of the perfected intellectual property right which was the focus of the R&D in the first place.

The choice to bring suit is often equally undesirable because the existence of the intellectual property right in one component of the product can give rise to a facile but extremely costly counterclaim of illegal tying.

Adoption of the rule of reason standard for intellectual property licensing arrangements would remove the bulk of these uncertainties set forth above. This would make R&D planning a more rational process, will decrease unnecessary uncertainty and risk, and therefore encourage R&D investment, especially by experienced R&D investors.

2. In your testimony, you state that this bill will help U.S. companies compete with foreign competitors. Please explain why you think this bill will be a net plus for U.S. firms competing in world markets.

2. While our testimony did not directly address this subject, the generally accepted framework for the stated position is that this bill will aid a systems supplier in its worldwide competition against would-be competitors who chose to supply only individual components of that system. To the extent that U.S. manufacturers of high-technology products tend towards being systems suppliers and foreign competitors tend towards the supply of individual components, S. 438 makes it possible for U.S. manufacturers to compete more realistically against the latter.

3. Tying arrangements sometimes are described as pernicious -because they allow desirable products to be tied to other, perhaps less desirable, products. In your industry, it would appear that we often are talking about inter-related parts of the same machine. Is that correct?

3. Absolutely correct. The problem has arisen because, nowadays, virtually every high-technology product contains at least some component which is the object of an intellectual property right. In some instances it makes sense to speak of the protected element as a separate product (as with applications software for personal computers). In other cases, the protected component is so much a part of the device so as to be inseparable; namely that neither part can or ought to be permitted to operate without the other. We believe that the arrhythmia algorithm demonstrated to the Committee falls into the latter category.

There is no clear guidance in the law as to where to draw the line between separate products which are bundled together, on the one hand, and single products which can not or ought not be unbundled, on the other. Whether two components are or ought to be treated as separate products should be determined on a case by case basis, taking all relevant facts into consideration. The single fact that a particular component happens to be protected by an intellectual property right should not, in and of itself, be dispositive as to whether that component ought to be considered as a separate product for purposes of a tying analysis.

4. What is your response to the charge that, by tying its products, Hewlett-Packard is simply attempting to block other firms from entering the market and competing with its products?
4. If the Congress or the courts sought to completely prevent a manufacturer from ever blocking any competition through the use of tying, then the appropriate legislative or judicial response would be to outlaw all tying. Neither Congress, nor the Courts has reached that result, and neither has perceived all tie-ins to be evil or to be prevented at all costs.

For the vast majority of the tie-ins, the Congress and the courts agree that a stringent market power test should be used to separate those tie-ins which are desirable from those which are not. Since the rule works so well for so much of the tying activity which is brought into question, we see no reason to carve out an exception creating virtually irrebuttable per se illegality for tie-ins which involve a product which contains a protected element of intellectual property.

Hewlett-Packard's support for this legislation is based upon its belief that intellectual property tie-ins have benefits to society, are generally imposed for good business reasons and not for the purpose of blocking competition, and that licensors should be given the opportunity to prove their value under a rule of reason standard.

RESPONSE OF SANFORD FEMAN TO
QUESTIONS FROM SENATOR DECONCINI

1. As you know, elimination of treble damages for antitrust violations is very controversial in Congress. Why do you believe that the detrebling provisions of S. 438 are appropriate? What about licensing of intellectual property is particularly appropriate for detrebling?

1. We believe that the "detrebling" of damages for violations of the antitrust laws involving intellectual property contracts is an appropriate adjunct to the remainder of S. 438. This is because the conditions in which treble damage penalties are appropriate are not present in the intellectual property licensing transactions addressed by S. 438.

Treble damage awards for antitrust and other violations are most appropriate in circumstances where:

- 1-the elements of the violation are reasonably easy to understand, and,
- 2-the harm to competition and to society is relatively great.

In other words, it is appropriate to punish a violation with treble damages when a party who can be charged with knowing what he or she is doing acts to cause great harm to competition and to society.

S. 438 would adopt the rule of reason standard for testing the legality of intellectual property arrangements. The rule of reason involves the balancing of "harm" to competition caused by the activity being analyzed against "good" caused by that same activity. Because licensing transactions are relatively complex, and have many benefits as well as potential harms, they are appropriate for rule of reason treatment, and neither of the two triggering circumstances justifying treble damages is satisfied.

We unnecessarily chill business decisionmaking when we apply severe penalties to situations in which the parties cannot easily identify whether or not a particular contractual condition will be found, after analysis, to have failed the rule of reason test.

2. Probably the most useful part of S. 438 is the provision related to tying arrangements. Why should intellectual property tying arrangements differ from other cases?

2- We believe that S. 438 should be passed in order to correct inappropriate and adverse treatment which is afforded intellectual property tying arrangements by some courts. We do not seek to create an antitrust exemption for intellectual property tying arrangements.

In considering non-intellectual property tying arrangements, courts have required a rigorous inquiry into the existence of market power, which the defendant must be held to possess if a violation is to be found. When confronted with intellectual property tying arrangements, however, some courts, such as the one in the *Digidyne* case, have presumed the existence of market power, independent of any inquiry into its true existence. The result has been that an intellectual property tying arrangement may be held to be illegal by a court upon a far lesser showing than a similar tying arrangement which does not involve intellectual property.

The proposed legislation requires an inquiry into the true existence of market power for intellectual property tying

arrangements. This will put such arrangements on a more equal footing with non-intellectual property tying arrangements and will go a long way toward correction of the currently existing unfair treatment.

In addition, in those intellectual property tying arrangements where true market power does exist, the application of the rule of reason allows a court to consider whether the market power is or is not a socially desirable consequence of ownership of associated intellectual property.

3. How is the consumer benefited by this provision of S. 438? Why wouldn't he or she be better off being able to buy the tied product on the open market? Why should Congress legislate a preference for such tying arrangements rather than letting the marketplace decide how such products should be sold?

3. This question takes us to those issues which lie at the heart of Hewlett-Packard's decision to support S. 438. We believe that passage of this important legislation is essential to protect the right of a domestic manufacturer to choose to pursue a strategy of manufacturing high quality products. This was the main thrust of HP's testimony in the joint hearing on October 20, 1987.

HP (along with many of our competitors) has built its reputation on high quality complex products (as opposed to lower-cost and lower quality) products. One of the rewards we believe we are entitled to is lower "after sale cost" associated with our products, including low costs associated with warranty repair and near zero costs associated with product liability lawsuits. Those companies who have chosen the alternate strategy of building lower-quality products, can expect to have higher after-sale costs, including higher warranty costs, and more and larger product liability damages. The antitrust laws should be flexible enough that a manufacturer like HP is not discouraged from offering its marketing alternative. A rule of reason would allow the marketplace, and not arbitrary antitrust rules, to determine how products should be sold.

Current antitrust laws can also distort the market's ability to offer fair and meaningful consumer choices because of these laws' conjunction with the present state of product liability litigation. If a high-quality system manufacturer (like HP) is required (as it may now be) to unbundle its products -- such as the heart arrhythmia monitoring system demonstrated to the committees last October -- then, in the final analysis, HP could be liable (under a joint and several liability theory) for damages caused by a low-cost component whose connection to the system was "permitted" or "mandated" by the requirement to unbundle. This is detrimental to consumers because it forces manufacturers of high quality products to raise prices to cover the added risk and expense of litigation caused by these products. It is, of course, further detrimental to those consumers who purchase products which actually harm them or their businesses.

Professor Carl Shapiro

February 2, 1988

Senate Judiciary Committee
Subcommittees on Technology and the Law & Antitrust, Monopolies
and Business Rights

Intellectual Property Antitrust Protection Act of 1987

Answers to Additional Questions

Questions from Senator Leahy

Question #1:

In your written testimony, you suggested that current incentives for American firms to undertake R&D are inadequate. How are they inadequate? What can we do to boost incentives for R&D?

Answer:

Economists measure private companies' incentives to undertake research and development by the profits they can expect to earn from their discoveries. These private incentives are commonly smaller than the public incentives to conduct R&D, which account for the benefits such R&D generates for other members of society.

Economists generally recognize that R&D generates an unusual amount of so-called external benefits, i.e., benefits enjoyed by parties other than those incurring the research and development expenses and risks. When a private firm makes a research discovery, several other groups benefit: (1) other firms that can use the discovery in their production activities, either through imitation or by acquiring a license on favorable terms, (2) other researchers that can build on the discovery in their own R&D, and (3) consumers who enjoy new and improved products and/or lower prices for existing products.

In the light of these important external benefits, many economists believe that American firms' incentives to undertake R&D are inadequate: as a country, we would be better off if more resources were devoted to research and development.

One way in which we can boost incentives for R&D is to relax the antitrust constraints on innovators. Encouraging rather than discouraging research joint ventures is one way to meet this goal. Another is to give more favorable antitrust treatment to the licensing of intellectual property, as S.438 aims to do. Yet another way to promote R&D is to fight for strong worldwide patent protection for American innovators. Finally, we could put in place tax credits for research activities.

Question #2:

In your testimony, you state that this bill will help U.S. companies compete with foreign competitors. Please explain why

you think this bill will be a net plus for U.S. firms competing in world markets.

Answer

By giving innovative firms more latitude in marketing their inventions in the United States, S.438 should provide an inducement for American firms to develop intellectual property. These patents will give American firms strategic advantages in competing with foreign enterprises.

In an international context, it is worth noting that the licensing of American-owned patents to foreigners, direct foreign investment motivated by American-owned intellectual property, and the export of high-tech products produced in America have been substantial sources of export income for the U.S., even during a period in which we have run a large trade deficit. If S.438 succeeds in stimulating the development of American-owned patents, it could strengthen some of our important export industries.

Question #3:

You heard Mr. Feman, who represents a large high-tech company, testify in support of the bill. What impact would S.438 have on individual inventors, small companies, and consumers?

Answer

This is an important question, and I am glad to have a chance to answer it. Any inventor - large or small - will have some additional latitude in licensing his or her invention if S.438 becomes law. Individual inventors and small companies are most likely to use licensing as a means of making their inventions available on a widespread basis (some large companies may be able to achieve the same effect wholly in-house without the need for licenses). So, S.438 may be at least as important to small companies as to large. Also, a legal presumption of market power from a patent is most unreasonable when the patent is owned by a small company, so these patentees stand to benefit from an application of a rule of reason.

Consumers also stand to benefit from S.438, for two reasons. First, by stimulating more innovation, S.438 can potentially give consumers superior products from which to select. Second, S.438 will permit tying arrangements that serve legitimate business purposes and are beneficial to consumers. Examples of ties that benefit consumers include tying to improve quality control and tying to prevent free-riding on support services by rival firms.

Question #4:

In your written testimony you cited an article by Professor Louis Kaplow of the Harvard Law School as support for your view that antitrust law should treat economic power associated with patents more favorably than it does other forms

of economic power. As you know, Professor Kaplow testified in the House against Congressman Fish's bill, and has been asked to comment on S.438 as well. Would you briefly highlight the areas where you and Professor Kaplow disagree?

Answer

Upon reading Professor Kaplow's testimony in the House, and after speaking with him, I believe our differences are less than they might appear. He is primarily concerned that the language of the bill might permit price fixing to be judged under the rule of reason. I too have stated that price fixing should be per se illegal, and am on record as opposing detrebling in general. That leaves the tying area. Regarding tying, Professor Kaplow recognizes that the elimination of the per se prohibition "poses a much closer question than that involved with price-fixing." I suspect I differ from Professor Kaplow on the application of the rule of reason for two reasons: first, because I am accounting for the effects of antitrust restrictions on incentives to innovate, and second because I do not share his extreme skepticism about the courts' ability to apply the rule of reason.

Question #5:

In your written testimony, you stated that courts should inquire into whether a less restrictive arrangement would have served the licensor's legitimate goals equally well. In the tying context, some courts have inquired whether tying was the least restrictive alternative available to the licensor. That is not the standard you are advocating the courts use, is it?

Answer

No. I simply meant that, as part of the rule of reason, the courts should attempt to determine whether restrictions in a licensing agreement were necessary to achieve a legitimate business goal, or whether an alternative arrangement could have served that same goal in a less restrictive manner.

Questions from Senator DeConcini

Question #1:

Probably the most useful part of S.438 is the provision related to tying arrangements. Why should intellectual property tying arrangements differ from other cases?

Answer

Intellectual property deserves special antitrust treatment because the development of patents, copyrights, etc., generates benefits to parties other than those developing it. Such external benefits come from imitation, from licensing, and when other inventors build on a given discovery. In the presence of such external benefits, the public interest is served by encouraging invention; applying the rule of reason rather than a per se rule to tying has this effect.

Question #2:

How is the consumer benefited by this provision of S.438? Why wouldn't he or she be better off being able to buy the tied product on the open market? Why should Congress legislate a preference for such tying arrangements rather than letting the marketplace decide how such products should be sold?

Answer

Let me stress that I do not advocate, and S.438 does not involve, any exemption of tying from the existing antitrust laws. I entirely agree with your premise that tying can lessen competition and harm consumers. But ties involving intellectual property also can benefit consumers. Since some ties are pro-competitive and some are anti-competitive, a rule of reason approach is the appropriate one.

There are two ways in which ties can benefit consumers. First, by rewarding innovators they can stimulate R&D that leads to new products and superior processes of production valued by consumers. Some of these new products might never be developed if tying is per se illegal. Second, some ties are in and of themselves pro-competitive, as when the tie serves a quality control function, such as Mr. Feman was suggesting for Hewlett Packard's heart monitor.

Senator LEAHY. Our next witnesses are Mr. Taylor, Mr. Susman, and Mr. Brown. I welcome you all.

Gentlemen, before we started, Congressman Fish and I made clear that the per se rule should continue to apply to horizontal and vertical price-fixing, so I hope I can count on some of you to help me draft that.

S. 438 addresses licensing practices that have been singled out for per se condemnation under the antitrust laws. Under the per se rule, if a contract arrangement falls into one of several pigeonholed categories, the court automatically strikes it down without considering the arrangement's procompetitive benefits.

Per se condemnation traditionally has been reserved for practices that clearly restrain competition, yet there is mounting evidence that some licensing practices like tying are beneficial.

So I am looking forward to your comments on how we could promote those benefits while retaining strong antitrust enforcement.

Naturally, your full statements will be part of the record. Senator Thurmond has questions that will be submitted for the record.

I will yield to Senator Metzenbaum, because I know you wanted to call on one of the witnesses first.

Senator METZENBAUM. Yes. I want to say that seldom do I have the opportunity to have two out of three witnesses appearing on a panel of people whom I know well. Tom, of course, used to be part of the staff here, and I am happy to see you again.

I am particularly pleased to see my friend Jack Brown here, who has been a long-time friend of mine. I had to make a speech this morning, but I am glad I got here in time to hear you. I am going to have to leave after your statement is made, and will have to miss you, Tom, and you, Mr. Taylor, but it is nice to see all of you, and I know we are going to hear some gems of wisdom.

Mr. BROWN. Thank you, Senator.

Senator LEAHY. Mr. Brown, because Senator Metzenbaum is going to have to leave, let us start with you, sir, please.

STATEMENTS OF A PANEL, INCLUDING JACK E. BROWN, ESQ., BROWN & BAIN, PHOENIX, AZ; ROBERT P. TAYLOR, ESQ., ON BEHALF OF THE AMERICAN BAR ASSOCIATION; AND THOMAS M. SUSMAN, ESQ., ROPES & GRAY, WASHINGTON, DC, ON BEHALF OF DIGITAL EQUIPMENT CORP.

Mr. BROWN. Senator Leahy and Senator Metzenbaum, rather than refer to my written statement, which you have and which I hope will receive some attention, in light of what was said earlier this morning and what I have gathered that my friends, Mr. Taylor and Mr. Susman, are going to say, I hope that I can in rather short compass at least address briefly four myths that ought not to influence consideration of this bill.

The first is the myth that the per se rule is opposed to reason or what is reasonable. That just is not so. It is consistent with your stated desire, Chairman Leahy, to condemn only agreements that are anticompetitive.

Now, I understand and appreciate that at this point that the reach of the bill with respect to horizontal price-fixing has been appreciated and will be addressed.

I do have a comment with respect to what was handed to me this morning as a proposed amendment, and I will be glad to take that up with you. But I would like particularly to address that myth. And what I have said, that the per se rule is not inconsistent with being reasonable, or the rule of reason itself, includes tie-ins.

In that regard, we ought to appreciate that there are lots of situations in which innovation comes from new entrants into the business that are impacted by tying arrangements, adversely, and I would like to talk about that.

Second, I would like to address the myth that the bill will induce more spending on research and development, or inspire innovative activity. That is a prime goal and consideration in antitrust and the law against tie-ins in particular. That law against tie-ins promotes innovation, and I would like to talk with you about that. That is one of its main objectives. That is the reason why Congress was so opposed to tie-ins when they enacted the Clayton Act in 1914.

The third myth I would like to address is that this bill will help small companies in some way in licensing. I do not think that is true. And I certainly think it is not true that it is going to help small companies in licensing foreign companies in particular, which is a point that Congressman Fish mentioned.

The fourth myth is that the judiciary, the judges, have been hostile to intellectual property protection, and in particular that the *Data General* case in the ninth circuit requires Hewlett-Packard to unbundle its medical instruments, or that that case requires unbundling of any particular product. The need for quality control, for example, that was addressed by the Hewlett-Packard attorney and representative, I think, eloquently, is an absolute defense. The *A. O. Smith* case has established that under present law, and I think it is universally recognized by every antitrust lawyer, and it is a good, sound rule.

Well, having said that much, let me say an additional word about the proposal that we should abandon the per se rule of illegality in all cases involving intellectual property licenses, a proposal that I have described as pernicious.

The proposed elimination of price-fixing from the scope of the bill is interesting. I would point out that the same reasoning applies to licenses which effectuate output limitations or market divisions among competitors. And as far as I know, the proposed amendment does not address that question. Those are also per se unreasonable and for the very same reason—because they are particularly, in accordance with experience, plainly anticompetitive, and because to try and have a rule of reason inquiry with respect to those things would in effect mean that they would never be challenged under the antitrust law given what the rule of reason inquiry means today.

I should say that a fifth myth is that doing away with the per se rule and treble damages will not do anything to the antitrust law. Quite to the contrary. It will mean, the way rule of reason cases have been developed today, that no one in private practice, at least, will dare to undertake a case where they would be faced with the kind of demonstrations that are required under a rule of reason inquiry. That is exactly what the Supreme Court appreciated and ad-

dressed as the reason for a per se rule. In *Northern Pacific*, you will recall the statement of the court that the per se rule avoids the necessity for an incredibly complicated and prolonged economic investigation, which they also pointed out was usually fruitless when undertaken.

No private plaintiff could afford a serious case where they were faced with rule of reason requirements of the courts. I am not suggesting that all those requirements are wrong. I am suggesting that in those cases where you have, in accordance with experience, demonstrated anticompetitive effects of a practice, you ought not to try and change the law by statute and require the courts to undertake that which is fruitless.

I am not sure how much more time I have. I want to address those things which concern you——

Senator LEAHY. It has expired, but go ahead and take some more. That is all right.

Mr. BROWN. Let me talk particularly, I suppose, about the *Data General* case; I will just do that—and the question of innovation, which particularly concerns me.

On innovation, let me say that I have devoted a good part of my professional life to protecting intellectual property, and the matter of innovation is of tremendous concern to me. I have argued elsewhere, and I would today, that that is the most important ultimate question in economics, and the focus on every consideration of a law in this area ought to be whether it promotes or hinders innovation.

My belief is that the per se rules as presently employed by the courts do not conflict with the encouragement of innovation. Since tying cases are a central question here, and they seem to occupy such a disproportionate amount of attention in the general debate, I would point out, as has the Supreme Court, that a tying arrangement inherently creates a barrier to entry in the manufacture of both the tying product and the tied product because it requires a new entrant, prepared to manufacture both items in order to compete on a par with the first entrant. Thus the tie operates indirectly, but in a significant way, to inhibit and stultify innovation.

In the *Data General* case, you ought to take note of the fact that the important innovation was by Fairchild Camera and Instrument, the company that I have represented for many years, in developing the first microprocessor, 16-bit microprocessor, I should say, which operated with the speed of a minicomputer.

That product never reached the marketplace in a serious way and was driven out of business by the litigation. We would have had the personal computer at least a year earlier if that product had been able to be marketed.

Now, in terms of what the court of appeals did in the ninth circuit, I think that is widely misunderstood.

The statement, which came from *Loew's* and other Supreme Court cases, in the opinion of the court of appeals that if you have a copyright or a patent, you can have presumed market power, took a very small part of the opinion and was an insignificant element in the case overall at trial. But if you want to address that question, we can do so. I do not think it is of great significance——

Senator LEAHY. No. I really do not want to relitigate the *Data General* case here——

Mr. BROWN. I don't, either.

Senator LEAHY [continuing]. And also knowing that we are going to go to a rollcall vote in about 20 minutes, I also would like to give Mr. Taylor and Mr. Susman a chance to talk before we have to adjourn.

Mr. BROWN. All right.

Senator LEAHY. And I know that Senator Metzenbaum wants to ask some questions.

Mr. BROWN. I will conclude with that. But I would be appreciative, if you want to have a bill addressing the question of presumptions, which I do not think is terribly significant, I will be happy to be of assistance in drafting such a law. That would be a narrow kind of question to be addressed appropriately, I think.

Senator LEAHY. Well, I may well be calling on you on that, Mr. Brown, because I was very impressed by your prepared statement, the depth of it, and I appreciate very, very much the amount of work that has gone into it.

[Prepared statement and Curriculum Vita of Mr. Brown follow:]

STATEMENT
of
JACK E. BROWN
before the
SUBCOMMITTEES on
TECHNOLOGY AND THE LAW
and
ANTITRUST, MONOPOLIES AND BUSINESS RIGHTS
of the
COMMITTEE ON THE JUDICIARY
of the
UNITED STATES SENATE
on
S.438 (proposed with the short title of
"THE INTELLECTUAL PROPERTY ANTITRUST
PROTECTION ACT OF 1987")

October 20, 1987

Senators Leahy and Metzenbaum and Members of the Subcommittee:

My name is Jack E. Brown. I am a lawyer engaged in practice with the firm of Brown & Bain, a professional association, with offices in Phoenix, Arizona and an affiliated office (Brown & Bain, a partnership affiliated with a professional association) in Palo Alto, California.

As may be seen from the curriculum vita submitted, my practice has been heavily committed to matters relating to antitrust and to the protection of intellectual property, often related subjects. Many of the cases listed in the curriculum vitae in which I was a lead trial counsel or presented the appellate argument are generally regarded as leading cases which were significant and received wide attention throughout the United States. In addition to such cases, my firm has acted as counsel for many other companies in many other cases involving intellectual property and antitrust claims in a wide variety of industries and technologies (e.g., medical instrumentation, fabrication equipment, paper mill control equipment, logic simulators, disk drives, picture telecommunication equipment and glass manufacturing processes).

I appear here today in opposition to S.438. In my view, the proposed legislation is unnecessary to protect legitimate intellectual property licensing practices and would be harmful in undermining useful antitrust doctrines under the present statutory provisions.

I

The Proposed Elimination of Per Se Illegality

First, the proposal that we should abandon the per se rules of illegality in all cases involving intellectual property licenses is pernicious.

The doctrine of per se illegality, as explained by the Supreme Court, is not antithetical to the "rule of reason" which governs in all restraint of trade cases; it is rather a pronouncement that certain agreements or practices are per se illegal because their "nature and necessary effect are so plainly anti-competitive"¹ or, stated otherwise, because of "their pernicious effect on competition and lack of any redeeming virtue."²

Thus, per se illegality is declared in only a few situations--essentially, in the present context, in cases involving agreements among competitors to fix prices, limit output or divide markets and in tie-in cases.³ There is no good reason to abandon per se illegality in such cases merely because a conveyance of intellectual property rights may be involved.

¹ National Soc'y of Professional Engineers v. United States, 435 U.S. 679, 692 (1978).

² Northern Pac. Ry. v. United States, 356 U.S. 1, 5 (1958).

³ See Catalano, Inc. v. Target Sales, Inc., 446 U.S. 643 (1980) (horizontal price-fixing); California Retail Liquor Dealers Ass'n v. Midcal Aluminum, Inc., 445 U.S. 97 (1980) (vertical price-fixing); Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2 (1984) (tying arrangements); United States v. Topco Assocs., 405 U.S. 596 (1972) (horizontal market divisions).

A. Agreements Among Competitors Fixing Prices, Restricting Output or Dividing Markets.

Permit me to deal first with the illegal per se doctrine in price-fixing cases.

Many antitrust critics today favor the abandonment of any per se rule in cases involving only vertical price-fixing.⁴ In intellectual property cases, they favor a larger scope for the approval, in United States v. General Electric Co., of resale price restrictions in patent licenses.⁵ There is much to be said for that view and I shall leave that debate for another day.

⁴ The Solicitor General has invited the Supreme Court to re-examine per se illegality of price restraints in such cases; the invitation was declined in Monsanto Co. v. Spray-Rite Serv. Corp., 465 U.S. 752, 761 n.7 (1984).

⁵ United States v. General Electric Co., 272 U.S. 476 (1926), approved a General Electric license to Westinghouse to manufacture tungsten filament light bulbs under the General Electric patents on condition that Westinghouse maintain the prices established by General Electric for its own sales.

It is widely recognized that subsequent cases substantially eroded the General Electric holding to the point where it is a precedent of slight and uncertain value. See Interstate Circuit v. United States, 306 U.S. 208, 228 (1939) (refusing to apply the General Electric case where the price restriction applied to copyrighted movies and other entertainment); United States v. Univis Lens Co., 316 U.S. 241, 250 (1942) (refusing to apply the General Electric case where the price restrictions were on the resale of a patented product because the first sale "exhausts the monopoly in that article"); United States v. Line Material Co., 333 U.S. 287, 314-15 (1948) (declaring unlawful price restrictions in a cross-license agreement of two "blocking" patents); United States v. United States Gypsum Co., 333 U.S. 364, 399-401 (1948) (invalidating price restrictions in patent licenses on the ground that the licenses were in aid of a cartel among competitors). The cited cases are analyzed in Furth, Price Restrictive and Patent Restrictive Licenses Under the Sherman Act, 72 Harv. L. Rev. 815 (1958).

More recently, the Supreme Court divided equally on the question of overruling the General Electric case outright in

However, there is little if any support--even among the most ardent and devoted members and supporters of the University of Chicago School of economists, who generally take a jaundiced view of the antitrust laws--for elimination of the rule that horizontal price-fixing is to be treated as per se illegal.⁶

And there is little if any basis to view with greater favor or solicitude horizontal price-fixing activity incidental to intellectual property licenses. Indeed, patent licenses have been found to have been used to create cartels serving to restrain competition among competitors.⁷

For present purposes, the same analysis applies to licenses which effectuate output limitations or market divisions

United States v. Huck Mfg. Co., 382 U.S. 197 (1965), aff'g 227 F. Supp. 791 (E.D. Mich. 1984), but may have given the case new life in Broadcast Music, Inc. v. CBS, 441 U.S. 1 (1979) (approving an arrangement for pooling copyrights for licensing by a single agency). Cf. Illinois Corporate Travel, Inc. v. American Airlines, Inc., 806 F.2d 722, 724 (7th Cir. 1986) ("General Electric is healthy").

⁶ See P. Hoff, Inventions in the Marketplace: Patent Licensing and the U.S. Antitrust Laws 11 (1986):

"[E]ven those who see no conflict between vertical arrangements involving patent licenses and the anti-trust laws agree that licensing arrangements may most certainly run afoul of the antitrust law if the patent arrangements disguise horizontal collusion between competitors."

⁷ United States v. Line Material Co., 333 U.S. 287 (1948).

Cf. Baxter, The Definition and Measurement of Market Power in Industries Characterized by Rapidly Developing and Changing Technologies, 53 Antitrust L.J. 717, 725-26 (1984):

"Price maintenance clauses in patent licenses may very well be a smokescreen for inducing a wide set of participants to use your technology and suppress equally good technologies, in order to be able to take advantage of a patent monopoly regime."

among competitors.⁸ The Hartford-Empire case was one in which the Supreme Court invalidated a network of cross-licenses among manufacturers of glassware where various output restrictions had the effect of regulating competition among the licensees.⁹

So far as I can see, S.438 makes no distinction of any kind between or among different kinds of cases and, instead, directs the wholesale elimination of any illegal per se rule under any of the antitrust laws in all cases involving intellectual property conveyances. Moreover, so far as appears, competitors wishing to escape the present per se rules affecting anticompetitive agreements could do so simply by including the desired anticompetitive provisions in a patent, copyright or trade secret cross-license agreement. I venture to suggest that it will not take astute antitrust practitioners more than a day to see the availability of that ready device for safeguarding against antitrust liability.

⁸ See National Collegiate Athletic Ass'n v. Board of Regents, 468 U.S. 85, 100 n.21 (1984) ("[w]hile judicial inexperience with a particular arrangement counsels against extending the reach of per se rules . . . the likelihood that horizontal price and output restrictions are anticompetitive is generally sufficient to justify application of the per se rule without inquiry into the special characteristics of a particular industry") (citations omitted). See also Baxter, Legal Restrictions on Explanation of the Patent Monopoly: An Economic Analysis, 76 Yale L.J. 267, 339 (1966).

Section 261 of the Patent Code provides that a patentee may "grant and convey an exclusive right under his . . . patent to the whole or any specified part of the United States." 35 U.S.C. § 261. That provision may provide a special authorization for territorial restrictions in patent licenses. See Dunlop Co. v. Kelsey-Hays Co., 484 F.2d 407, 417 (6th Cir. 1973), cert. denied, 415 U.S. 917 (1974).

⁹ Hartford-Empire Co. v. United States, 323 U.S. 386, 406-07 (1945).

The problem with the Bill which I have alluded to is magnified by the fact that it extends its protection to conveyances of trade secret rights. No doubt there are many patents that are not worth much, but at least they presumably represent a minimal degree of invention. And copyrights, while affording protection only against copying, at least identify original creative endeavor. The law of trade secrets extends protection to a much wider and oftentimes to a much more uncertain and ambiguous range.¹⁰ Virtually every business has its share of trade secrets, often combined in an aggregate referred to as

¹⁰ The American Law Institute Restatement of Torts § 757 comment b (1939) (the provision most often cited by American courts in trade secret cases) defines "a trade secret" as follows:

"A trade secret may consist of any formula, pattern, device or compilation of information which is used in one's business, and which gives him an opportunity to obtain an advantage over competitors who do not know or use it. It may be a formula for a chemical compound, a process of manufacturing, treating or preserving materials, a pattern for a machine or other device, or a list of customers"

Section 1 of the Uniform Trade Secrets Act, adopted in sixteen states as of July 1, 1986, defines a "trade secret" to mean

"information, including a formula, pattern, compilation, program, device, method, technique, or process, that: (i) derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use, and (ii) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy."

For a comparison of patent law and trade secret law, see Kewanee Oil Co. v. Bicron Corp., 416 U.S. 470 (1974).

"know-how," creating considerable opportunities for antitrust abuse through the medium of "know-how" licenses. For example, a licensor of manufacturing know-how accompanying a patent license might claim that the license restrictions on use of the know-how continued for many years after expiration of all of the relevant patents (theoretically, forever) and precluded the licensee from developing a competing technology free of the restraints imposed by the license. Antitrust theorists always have understood the danger that industry-wide patent and know-how licenses might discourage licensees from developing innovative competing technologies.¹¹ That is a danger which, it seems to me, would be enhanced by the enactment of S.438.

¹¹ See Statement by Charles F. Rule, Deputy Assistant Attorney General, Antitrust Division, before the John Marshall Law School, at 8 (Feb. 22, 1985), acknowledging that patent license restrictions may be anticompetitive where they are used "to suppress the creation or development of competing technologies." See also the remarks of Roger M. Andewelt before the ABA Patent, Trademark, and Copyright Section entitled "The Antitrust Division's Perspective on Intellectual Property Protection and Licensing--The Past, the Present, and the Future" (July 16, 1985).

The Task Force engaged in revising the Antitrust Guide for International Operations issued by the United States Department of Justice in 1977, while arguing that patent licenses should be viewed generally as vertical relationships, acknowledged antitrust concerns "if there is a horizontal element to the restraint, or if there is no significant interbrand competition," and explained:

"This might occur where the patent license and its provisions serve to restrict competition in the use of previously available technology or serve to reduce competition in the development of new technology."

Task Force Report: The Antitrust Guide For International Operations Revisited, 54 Antitrust L.J. 841, 845-46 (1985).

Assistant Attorney General Rule has advised that a license should be analyzed as a horizontal restriction if

Enactment of the proposed legislation presumably would remit all cases involving intellectual property conveyances to a full factual inquiry into the competitive effects of every challenged restraint under a "rule of reason" antitrust analysis. I hesitate to predict what that might mean in cases of horizontal price fixing, output restriction or division of markets, but I think it is safe to predict that the complexity of whatever inquiry is eventually required is likely to give pause both to litigants and to the courts.¹² The likelihood of a successful challenge to any restraint is bound to be decreased; that, after all, is plainly the ultimate objective of the proposed legislation.¹³ And, finally, the cost of whatever additional inquiry is required is likely to be forbidding to government prosecutors and to be daunting to even the richest and most daring of private litigants. The process of defining a relevant market (sometimes said to be a prerequisite in every "rule of reason" case)¹⁴

the parties "own or control competing technologies, and the license restricts their price or output decisions." Rule, The Antitrust Implications of International Licensing: Analyzing Patent and Know-How Licenses, [Current] Trade Reg. Rep. (CCH) ¶ 50,482, at 56,295 (Oct. 27, 1986).

¹² See Blecher, The New Antitrust As Seen By A Plaintiff's Lawyer, 54 Antitrust L.J. 43, 45 (1985).

¹³ Among the reasons given in recent rule of reason cases for dismissal of private suits were that the plaintiff could not or did not show: an adequately defined economic market in which competition could be properly assayed; the defendant's requisite market share (or other manifestation of market power) in a properly defined market; concerted action; anticompetitive effects in an industry at large or in a defined market; a sufficiently close connection between the arrangement complained of and alleged injury to competition; or antitrust injury to the claimant directly resulting from the alleged illegal conduct.

and determining the defendant's share of that market can in itself be enormously time-consuming and expensive. It seems inevitable that the net result will be that antitrust cases which under today's rules might be brought will never be brought, and many anticompetitive arrangements which under today's rules would not be entered into, will be considered and adopted.

B. Tying Arrangements.

Tying arrangements present a separate problem. Although tie-ins are nominally per se illegal under both section 1 of the Sherman Act and section 3 of the Clayton Act, it is well understood that the per se rule is not to be applied in any tie-in case except where a defendant's "market power" is demonstrated. Traditionally, the focus of inquiry has been on the defendant's power in the market for the tying product on the theory that "the essential characteristic of an invalid tying arrangement lies in the seller's exploitation of its control over the tying product to force the buyer into the purchase of a tied product that the buyer either did not want at all, or might have

¹⁴ See Rule, The Antitrust Implications of International Licensing: Analyzing Patent and Know-How Licenses, [Current] Trade Reg. Rep. (CCH) ¶ 50,482, at 56,295 (Oct. 27, 1986):

"The first step in the rule of reason analysis is to identify the technologies that are true economic substitutes for the patent being licensed and with which that patent competes. This determination is analogous to the process of defining markets in merger analysis."

¹⁵ Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2, 12 (1984).

preferred to purchase elsewhere on different terms."¹⁵ However, recent cases have imposed an additional requirement that there be "a substantial danger that the tying seller will acquire market power in the tied product market."¹⁶ In addition, there has been a perceptible, although still ambiguous, change in the meaning of "market power." The earlier cases tended to focus on the power accruing to a seller inherent in the tying product.¹⁷ Some later cases have shifted attention from the tying product to the "market for the tying product," calling for extensive market

¹⁶ Carl Sandburg Village Condo. Ass'n No. 1 v. First Condo. Dev. Co., 758 F.2d 203, 210 (7th Cir. 1985). That requirement also was set forth in the concurring opinion of Justice O'Connor in Jefferson Parish, 466 U.S. at 38. However, Justice O'Connor's opinion also stated: "If, on the other hand, the tying arrangement is likely to erect significant barriers to entry into the tied product market, the tie remains suspect." Id. at 39.

¹⁷ See Northern Pac. Ry. v. United States, 356 U.S. 1, 11 (1958).

"While there is some language in the Times-Picayune opinion which speaks of 'monopoly power' or 'dominance' over the tying product as a necessary precondition for application of the rule of per se unreasonableness to tying arrangements, we do not construe this general language as requiring anything more than sufficient economic power to impose an appreciable restraint on free competition in the tied product (assuming all the time, of course, that a 'not insubstantial' amount of interstate commerce is affected). To give it any other construction would be wholly out of accord with the opinion's cogent analysis of the nature and baneful effects of tying arrangements and their incompatibility with the policies underlying the Sherman Act."

Justices Harlan, Frankfurter and Whittaker dissented in Northern Pacific, arguing that some showing of defendant's dominance over the relevant market, or at least "of the 'uniqueness' of appellants' landholdings in terms of quality or use to which they may have been put," should have been required before the per se rule of unreasonableness for tying arrangements was invoked. Id. at 16.

analysis, including market definition and share-of-market measurement exercises of the kind employed in Section 7 merger or Section 2 monopolization cases.¹⁸

Moreover, the per se rule in tying cases is under serious threat of being eviscerated or abandoned altogether. The Anti-trust Division's 1985 Vertical Restraints Guidelines state that "[t]ying arrangements generally do not have a significant anti-competitive potential" and suggest a presumption favoring legality in the absence of proof of "a degree of market power in the tying market that approaches monopoly proportions."¹⁹ Four Justices in the Jefferson Parish case (Chief Justice Burger and Justices O'Connor, Powell and Rehnquist) expressed the view that "[T]he time has . . . come to abandon the 'per se' label and refocus the inquiry on the adverse economic effects, and the potential economic benefits, that the tie may have."²⁰ Those

¹⁸ See Jefferson Parish (holding that a 30 percent market share was insufficient to establish market power in the tying product market), preceded by United States Steel Corp. v. Fortner Enters., Inc., 429 U.S. 610, 620 (1977) (Fortner II) (requiring a showing that "the seller has some advantage not shared by his competitors in the market for the tying product"); A.I. Root Co. v. Computer/Dynamics, Inc., 806 F.2d 673, 675 (6th Cir. 1986) (affirming summary judgment against plaintiff because defendant did not possess the requisite economic power for an illegal tie). See also Dam, Fortner Enterprises v. United States Steel: "Neither a Borrower, Nor a Lender Be," 1969 Sup. Ct. Rev. 1, 23-28 (cited in Jefferson Parish and in Fortner II with approval).

¹⁹ Guidelines §§ 5.1, 5.2 and 5.3 n.35. For a fine critical view of the Guidelines, explaining that they "would seem more natural written in German," see Baker, "New Vertical Restraints Guidelines: Justice's Efforts to Influence Courts," National L.J. (Mar. 4, 1985).

²⁰ 466 U.S. at 35 (concurring opinion of O'Connor, J.).

four Justices also expressed a view of tying arrangements as frequently "procompetitive" ("more efficient," providing "economic benefits" and "advantages") or at least "entirely innocuous" and therefore not subject to condemnation.²¹ They further approved an assessment of "the economic advantages of joint packaging" to determine whether the combined sale of two products should be viewed as a single product for the purpose of antitrust analysis.²²

That brings us to consideration of the decision of the Ninth Circuit Court of Appeals in Digidyne Corp. v. Data General Corp.,²³ in which it was my privilege to represent Fairchild Camera & Instrument Corporation as one of the plaintiffs, to serve as lead counsel at the trial of the case and to present the argument on appeal. In that case, the court of appeals affirmed the jury verdict in favor of the plaintiffs as to market power and held that Data General had illegally tied the sale of its NOVA computers to the licensing of its operating systems software by refusing to allow the use of its software with any competing computer. At the outset of the case there

²¹ Id. at 35-42.

²² Id. at 40.

In a published dissent from denial of certiorari in Digidyne Corp. v. Data General Corp., 473 U.S. 908 (1985), Justice White, joined by Justice Blackman, endorsed the view that tying arrangements "may have procompetitive justifications" and should not be condemned "without considerable market analysis." Thus, it would appear that there are two additional Justices who are prepared to reexamine critically "what constitutes forcing power in absence of a large share of the general market." 473 U.S. at 908.

²³ 734 F.2d 1336 (9th Cir. 1984), cert. denied, 473 U.S. 908 (1985).

were a number of plaintiffs, each of whom manufactured a computer which utilized the same publicly available NOVA instruction set as was utilized for Data General's NOVA computers and therefore was capable of running the same operating system software. Fairchild's product was a microprocessor, which was thought to be the first 16-bit microprocessor that operated with the speed of a minicomputer. The microprocessor, of course, is the product which made possible the personal computer and, without exaggeration, inaugurated an industrial revolution.

The case is important to the present discussion because some supporters of the proposed legislation have cited the decision of the court of appeals as illustrating why a change in the law should be made. The aspect of the decision that has been subjected to the greatest criticism is its reliance on Data General's copyrights as giving rise to a presumption of economic power under United States v. Loew's, Inc. (the movie tie-in case).²⁴

I would submit that the decision does not pose a serious threat to any legitimate licensing activity and certainly does not call for such a radical, far-reaching measure as S.438.

²⁴ 371 U.S. 38, 45 (1962).

In Jefferson Parish, the Supreme Court similarly stated that "if the Government has granted the seller a patent or similar monopoly over a product, it is fair to presume that the inability to buy the product elsewhere gives the seller market power." 466 U.S. at 16. Assistant Attorney General Rule has also criticized that dictum as "wrong, and also very troublesome because of the negative impact it may have on pro-competitive licensing practices." Statement before the John Marshall Law School, at 8 (Feb. 22, 1985).

First, the case is truly a sui generis one. The subject of copyright was only a small part of the opinion of the court of appeals and a much smaller part of the case presented by the plaintiffs demonstrating Data General's economic power. No doubt this influenced the Department of Justice in concluding that "we cannot say that a properly instructed jury could not, as a matter of law, have returned a verdict in favor of [plaintiffs]" and that the case was "not an ideal candidate for certiorari."²⁵

Second, the Data General case is not the last judicial word on the subject of economic power in tying cases. Judge Easterbrook, who as a private practitioner authored Data

²⁵ Brief for the United States as Amicus Curiae in the Supreme Court of the United States on Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit at 18 (No. 84-761, May 1985).

One unique reflection of Data General's economic power, which provides a little of the flavor of the case, was Data General's Minimum Equipment Configuration ("MEC")-Program License Charge ("PLC") requirement. See 734 F.2d at 1343.

As a condition of every software license, Data General required that the licensee acquire from Data General a specified minimum amount of hardware or, alternatively, pay to Data General a charge--in addition to a software license fee--which was so high that it was viewed by virtually everyone as a "fine" or "penalty." Many of the items which customers were required to purchase were acquired by Data General from other manufacturers and resold at huge mark-ups; in 1979, for example, Data General's mark-up for such resales averaged more than 250%.

Many of the items manufactured by Data General were thought to be inferior in quality to items available from others. Not infrequently, customers were required to purchase equipment for which they had absolutely no use.

Professor Richard Schmalensee described the Data General scheme as "a classic demonstration of power over price."

General's petition for Supreme Court review, has already found an opportunity to criticize and refuse to follow the Data General case.²⁶ Criticism of a presumption of economic power emanating from patents or copyrights has been stimulated by the Data General decision.²⁷ Even if the presumption is maintained in full vigor in future cases, it is rebuttable. If it is true, as Professor Scherer has suggested, that "the vast majority of all patents confer very little monopoly power,"²⁸ that ought to be readily demonstrable and a debate as to which party will bear the burden of proof should not strike anyone as the most exciting question compelling the attention of the United States Senate.²⁹ In short, to the extent that there is any problem of interest, it is likely to be satisfactorily resolved by the courts in regular course.

Third, on the merits I would submit that the defense of tying arrangements advanced by the Chicago School of economists is overdrawn. As I have related, the per se rule against tying arrangements is today not invoked without a meaningful showing of economic power. In addition, leading cases have recognized

²⁶ Will v. Comprehensive Accounting Corp., 776 F.2d 665, 673 n.4 (7th Cir. 1985), cert. denied, 106 S. Ct. 1659 (1986).

²⁷ E.g., Note, The Presumption of Economic Power for Patented and Copyrighted Products in Tying Arrangements, 85 Colum. L. Rev. 1140 (1985).

²⁸ Scherer, The Value of Patents and Other Legally Protected Commercial Rights--Panel Discussion, 53 Antitrust L.J. 535, 547 (1984).

²⁹ See Brown, The Value of Patents and Other Legally Protected Commercial Rights--Panel Discussion, 53 Antitrust L.J. 535, 546-47 (1984).

and allowed sound business justifications--such as quality control and new product introduction--as absolute defenses in particular cases.³⁰ The other arguments advanced--for example, that tying arrangements are meaningless because a seller can recover only one monopoly profit or are benign because they are merely efficient metering devices--strike me as over-sophisticated rationalizations. They do not prove that a tying arrangement is required to accomplish whatever legitimate objective a seller may have. Nor do they counter the fact that, in each case, the seller expects to make sales of the tied product which it otherwise could not gain if each product was sold separately on its merits.³¹ In the last analysis, there remains a powerful truth in the common sense analysis stated by Justice Frankfurter in the Standard Stations case that

"Tying agreements serve hardly any purpose beyond the suppression of competition."³²

³⁰ Dehydrating Process Co. v. A.O. Smith Corp., 292 F.2d 653 (1st Cir.) (recognizing good will defense where, over seven years, defendant received numerous complaints, including from the plaintiff, when its unloading machines were sold for use with competitive silos), cert. denied, 368 U.S. 931 (1961); United States v. Jerrold Elecs. Corp., 187 F. Supp. 545 (E.D. Pa. 1960) (tie-in not illegal when industry is new and products both were required and unavailable from multiple sellers, illegality coming only after products became available from others), aff'd mem., 365 U.S. 567 (1961) (per curiam).

³¹ See Brown, The Value of Patents and Other Legally Protected Commercial Rights--Panel Discussion, 53 Antitrust L.J. 541-42 (1984).

³² Standard Oil Co. v. United States, 337 U.S. 293, 305-06 (1949).

The Supreme Court noted in Jefferson Parish the strong Congressional views which led to the condemnation of tying

If that is so, to eliminate any use of a per se rule in tying cases, already beset with increasingly difficult burdens of proof, would be to take a backward step.³¹

In sum, the per se rule in tying cases already is attenuated and subject to a high degree of judicial scrutiny. If the dictum according a presumption of economic power to the holding of a patent or copyright is bad law, it is without much significance and provides no justification for enactment of a worse statute with wide-ranging consequences.

arrangements in Section 3 of the Clayton Act, 38 Stat. 731 (1914). 466 U.S. at 10-11.

For current analysis of tying arrangements in terms other than those used by the Chicago School of economists, see L. Sullivan, Handbook of the Law of Antitrust § 152 (1977); Bauer, A Simplified Approach to Tying Arrangements: A Legal And Economic Analysis, 33 Vand. L. Rev. 283 (1980); Kaplow, Extension of Monopoly Power Through Leverage, 85 Colum. L. Rev. 515 (1985); Kaplow, The Patent Antitrust Intersection: A Reappraisal, 97 Harv. L. Rev. 1815 (1984).

³¹ I do not mean to suggest unqualified approval of all aspects of tie-in law as pronounced in prior cases. I would particularly invite renewed and continuing study of the definition of single and separate products, as suggested in Justice O'Connor's concurring opinion in Jefferson Parish, 466 U.S. at 39-40.

The case law took a bad turn in that regard in Fortner Enters., Inc. v. United States Steel Corp., 394 U.S. 495, 498 (1969) (Fortner I) (holding that the credit terms upon which the seller's houses were offered were separate from the houses), compelling an unnecessarily tortured opinion to reach an obviously sound result in United States Steel Corp. v. Fortner Enters., Inc., 429 U.S. 610, 622 (1977) (Fortner II) (holding that the defendant did not have economic power in the credit field). Much of the unease expressed by critics of the tying cases might be allayed, I suspect, if a more sensible standard were employed to define single and separate products.

II

The Proposed Elimination of Treble Damages

The provision of the proposed law that would eliminate treble damages (section 3(a)) would provide almost certain assurance that very few private suits ever would be filed and adequately prosecuted based on any kind of illegal arrangement involving an intellectual property license. Since private suits are oftentimes more important than government actions in protecting against antitrust misconduct, the elimination of treble damages as a remedy might well serve as a fatal blow to any kind of meaningful antitrust enforcement on a broad front.^{3*}

III

The Encouragement of Procompetitive Licensing of Intellectual Property

Finally, I would like to consider the claim that such legislation is necessary to encourage procompetitive licensing of intellectual property. I have no doubt that proponents of the legislation are well-intentioned in thinking that some good may come of it in assisting our high technology businesses beleaguered by foreign competitors. I just think they are wrong in looking for assistance in this kind of a proposal. Indeed,

^{3*} For a compelling statement explaining that the combined effect in the proposed legislation of requiring a "rule of reason" inquiry and the elimination of treble damages would make private suits impractical (and impossible for small firms), see the Statement of Jack E. Provine Before the Subcommittee on Monopolies and Commercial Law, Committee on the Judiciary, U.S. House of Representatives, Concerning H.R. 557 (April 30, 1987).

I fear a loss by eliminating the present mild restraints of antitrust on those competitors with conspiratorial or predatory inclinations.

As I understand it, a main justification offered for the Bill is that licensing restraints may be particularly important to small firms or individuals required to license their respective inventions in order to gain the manufacturing and distribution assets and skills of larger firms.³⁵ I have no difficulty in recognizing the need for, and benefits of, technology licensing in those instances (and in others as well), but I don't think it has been, or can be, shown that small firms or individuals--or anyone--require immunization from the per se rules in price-fixing or tying cases to fully exploit the benefits of technology licensing. Indeed, in the hypothesized case the small firms or individuals are by definition purely (or at least primarily) licensors, not competitors, with their licensees. Such licensors, of course, need not be troubled by the per se rule against horizontal conspiracies among competitors.

I am fully committed to the legal protection of intellectual property as a means of encouraging technological innovation. I have argued elsewhere that technological innovation is what ultimately matters in economics. The focus of attention must always be on whether, and the extent to which, a given

³⁵ Statement of Roger B. Andewelt, Deputy Assistant Attorney General, Antitrust Division, Before the Subcommittee on Monopolies and Commercial Law, Committee of the Judiciary, House of Representatives, Concerning H.R. 557 (April 30, 1987) ("Andewelt Statement").

rule promotes or hinders innovation.³⁶ My belief is that the per se antitrust rules do not conflict with the encouragement of innovation. I hope I have demonstrated in a small way that the antitrust prohibitions to which the per se rules pertain may, by assisting the competitive process, encourage technological innovation.

Since tying cases occupy such a disproportionate amount of attention in the general debate surrounding per se illegality, I would point out, as has the Supreme Court,³⁷ that a tying arrangement inherently creates a barrier to entry in the manufacture of both the tying product and the tied product because it requires a new entrant to prepare to manufacture both items in order to compete on a par with the first entrant. Thus, it seems to me, the tie operates indirectly, in a significant way, to inhibit and stultify innovation.³⁸

Finally, it has been argued that antitrust illegality may be proven without the benefit of any per se rule and, thus, "this legislation would not render lawful any anticompetitive

³⁶ Brown, The Value of Patents and Other Legally Protected Commercial Rights--Panel Discussion, 53 Antitrust L.J. 536, 543 (1984).

³⁷ See Jefferson Parish, 466 U.S. at 13 n.19, quoting at length from the dissenting opinion of Justice White in Fortner I, 394 U.S. at 512-14.

³⁸ I take some comfort in knowing that one of the harshest critics of the law against tying arrangements, Professor and Former Assistant Attorney General William Baxter, has at least noted that "every once in a blue moon, one can find a tie-in case where somebody is trying to erect entry barriers." Baxter, The Definition and Measurement of Market Power in Industries Characterized by Rapidly Developing and Changing Technologies, 53 Antitrust L.J. 717, 725 (1984).

licensing scheme."³⁹ That is so, but, as a practical matter, the legislation surely would render almost every anticompetitive licensing provision virtually immune from suit.

³⁹ Andewelt Statement at 9-10.

CURRICULUM VITA

OF

JACK E. BROWN

Professional Association:

Senior Member, Brown & Bain, P.A., Phoenix, Arizona
(1960 to date); Lecturer in field.

Education:

B.S. with distinction, Northwestern University, 1949;
LL.B., Harvard Law School, 1952.

Prior Associations:

Law Clerk, U.S. District Judge Charles E. Wyzanski, Jr., D. Mass., 1952-53; Cravath, Swaine & Moore, New York, New York, 1953-59; Law Clerk, Arizona Supreme Court Chief Justice Charles C. Bernstein, 1959; Evans, Kitchel & Jenckes, Phoenix, Arizona, 1959-60.

Bar Admissions and Professional Associations:

Admitted in: New York (1954) and Arizona (1959) state courts; U.S. District Courts for the Southern District of New York (1956), District of Arizona (1960), Northern District of California (1981); U.S. Courts of Appeals for the Second Circuit (1956), Ninth Circuit (1964), First Circuit (1976),

Third Circuit (1982); and U.S. Supreme Court (1972). Member of: American, Arizona and Maricopa County Associations; The Bar Association of the City of New York; American Arbitration Association (National Board of Directors (1983-87)); American Law Institute (1978 to date); Arizona Law and Technology Institute (Advisory Board (1982 to date)); Adjunct Professor and Lecturer on Antitrust, Law and Technology and Communications Law, Arizona State University School of Law.

Honors:

Distinguished Achievement Award, Arizona State University School of Law (1983); Speaker at Commencement Convocation, Northwestern University School of Speech (1984); Judge Pro Tem, Arizona Court of Appeals (1984).

Representative Writings and Lectures on Antitrust, Protection of and Intellectual Property and Related Subjects:

The Rise and Threatened Demise of the Prima Facie Tort Principle, 54 Nw. U.L. Rev. 563 (1959); Aspects of Protective Orders under Fed. R. Civ. P. 26(c), Federal Discovery in Complex Civil Cases 333 (1980); Trade Secret Litigation in the 1980's, Remarks at the Advanced Computer Law Invitational Conference, Scottsdale, Ariz. (Jan. 24-26, 1983); Enforcing Rights Against a Departing Employee, Remarks at the Institute for Corporate Counsel Third Annual Seminar, Los Angeles, Cal. (Mar. 15-16, 1984); Jack E. Brown on Computer Arbitration, Arbitration Times 5 (Spring 1984); Proprietary Rights Protection and the Spin-Off,

Panel presentation at the Fifth Annual Computer Law Institute, Los Angeles, Cal. (May 16-18, 1984), New York, N.Y. (Oct. 10-11, 1984) and Chicago, Ill. (Nov. 29-30, 1984); Copyright, Software and Integrated Circuits, Proceedings of the 1984 Sperry Lawyers' Conference 28 (Oct. 16, 1984); Protection of Corporate Information: Technology, Trade Secrets, Know-How--Where Are We Going?, Remarks before the American Corporate Counsel Association, Washington, D.C. (Oct. 22-23, 1984); The Value of Patents and Other Legally Protected Commercial Rights, 53 Antitrust L.J. 535 (1985) (panel discussion at the National Institute on Industrial & Intellectual Property in Philadelphia, Pa. (Oct. 11-12, 1984)); Trial of an Antitrust Case, Remarks at the Practising Law Institute Seminar, San Francisco, Cal. (Feb. 8, 1985); Antitrust Questions in Software Marketing: Pricing and Discounting for Multiple Marketing Arrangements; Tying Arrangements, Remarks at the Practising Law Institute on Computer Software and Chips: Protection and Marketing, San Francisco, Cal. (Summer 1985); Patent Arbitration: What You Need to Know--A Walk-Through Demonstration, Panel presentation at American Bar Association Program, Washington, D.C. (July 9, 1985); Copyright Protection of Computer Programs, Remarks at the Institute of Electrical and Electronics Engineers (IEEE) Spring Computer Conference, San Francisco, Cal. (Mar. 1986); Recent International Trends in the Legal Protection of Computer Software, 2 J.L. & Tech. 167 (1987) and Vol. 3.5 Computer Law & Practice 157 (1987) (adaptation of address delivered at the Tenth Anniversary Program of the Law and Computer Association

of Japan, Tokyo, Japan (Oct. 24-25, 1986)); Privacy Protection in the United States, Speech at the Tenth Anniversary Program of the Law and Computer Association of Japan, Tokyo, Japan (Oct. 24-25, 1986); Copyright Protection for Computer Programs, Remarks before the Massachusetts Software Council, Framingham, Mass. (Apr. 22, 1987).

Representative Intellectual Property and Antitrust Cases
in Which Mr. Brown Served as a Lead Trial Counsel
or Presented the Appellate Argument

<u>Client,* Matter and Any Reported Decision</u>	<u>Technology or Product Involved</u>	<u>Nature of Case</u>
APPLE COMPUTER, INC. v. Formula International, Inc., 562 F. Supp. 775 (C.D. Cal. 1983), <u>aff'd</u> , 725 F.2d 521 (9th Cir. 1984)	Operating system programs	Suit for alleged copyright infringement of operating system programs and patent infringement
APPLE COMPUTER, INC. v. Franklin Computer Corp., 714 F.2d 1240 (3d Cir. 1983), <u>cert. dismissed</u> , 464 U.S. 1033 (1984)	Operating system programs	Suit for alleged copyright infringement of operating system programs and patent infringement
APPLE COMPUTER, INC. v. Jobs, Cal. Super. Ct., No. 584898 (1985-86)	Advanced computer system for educational marketplace	Suit for alleged violation of fiduciary duty as Chairman of the Board and threatened misappropriation of confidential information

* The client represented by Brown & Bain appears in capital letters.

<u>Client, Matter and Any Reported Decision</u>	<u>Technology or Product Involved</u>	<u>Nature of Case</u>
BETHLEHEM STEEL CORP.: Luria Bros. and Co., Inc. v. Federal Trade Commission, 389 F.2d 847 (3d Cir. 1968), cert. denied, 393 U.S. 829 (1968)	Manufacturer of steel	Suit to restrain alleged monopolization and unfair competition by exclusive dealing contracts and arrangements
BURROUGHS CORP. adv. Kalil Bottling Co., 127 Ariz. 278, 619 P.2d 1055 (Ct. App. 1980)	Burroughs computer systems	Suit for alleged failure of system to perform in accordance with requirements
BURROUGHS CORP. adv. Retail Leasing Assocs./ REAP, No. 85-3379-W (D. Mass. 1986), Computer Industry LR, 2/24/86, p. 3,742	Burroughs computer systems	Suit for alleged failure to permit user and third-party maintenance provider to use proprietary documentation to service the installed computer systems
CABOT CORP. v. Frashier, Or. Cir. Ct., A7805-08907 (1978)	Silicon Tetrachloride Plant	Suit for alleged misappropriation of proprietary documents and trade secrets
FAIRCHILD CAMERA & INSTRUMENT CORP. adv. Data General, Del. Ch., No. 5314 (1977-87)	Fairchild 9440 emulation of Data General NOVA 1200 computer	Suit for alleged misappropriation of trade secrets
FAIRCHILD CAMERA & INSTRUMENT CORP.: In re Data General Corp. Antitrust Litigation, 734 F.2d 1336 (9th Cir. 1984), cert. denied, 473 U.S. 908 (1985)	Data General NOVA computers and operating Systems and the Fairchild 9440 microprocessors and related devices	Suit for alleged unlawful tying of computers to operating system software

<u>Client, Matter and Any Reported Decision</u>	<u>Technology or Product Involved</u>	<u>Nature of Case</u>
FAIRCHILD CAMERA & INSTRUMENT CORP. adv. General Instrument Corp., 56 A.D.2d 525, 391 N.Y.S.2d 829 (N.Y. App. Div. 1977); 67 A.D.2d 609, 412 N.Y.S.2d 9 (1979)	F8 microprocessor	Suit for alleged misappropriation of architecture of a microprocessor designed by Olympia Werke A.G.
FAIRCHILD CAMERA & INSTRUMENT CORP. adv. American Pacemaker Corp., Cal. Super. Ct., No. 448521 (1979-80)	Pacemaker	Suit for alleged product defect
FAIRCHILD CAMERA & INSTRUMENT CORP. adv. Motorola, Inc., 366 F. Supp. 1173 (D. Ariz. 1973)	Various semiconductor manufacturing processes	Suit for alleged misappropriation of trade secrets and breaches of fiduciary duty as an officer and director of corporation
FAIRCHILD CAMERA & INSTRUMENT CORP. v. National Semiconductor Corp., Cal. Super. Ct., No. P28633 (1976-77)	High density bipolar memories	Suit for alleged misappropriation of trade secrets and refusal to transfer invention of memory cell
FAIRCHILD CAMERA & INSTRUMENT CORP. adv. Texas Instruments, D. Texas, 160th J.D., No. 83-13310-H (1984)	Advanced integrated circuits and semiconductor	Suit for alleged threatened misappropriation of trade secrets components
INTEL CORP. adv. Advanced Micro Devices, Inc., Cal. Super. Ct., No. 626879 (1987)	Various advanced integrated circuits and microprocessors and related products	Suit to compel exchange of further products under technology exchange agreement

<u>Client, Matter and Any Reported Decision</u>	<u>Technology or Product Involved</u>	<u>Nature of Case</u>
INTEL CORP. adv. NEC, 645 F. Supp. 590 (N.D. Cal. 1986)	Microcode used in the 8080/86 microprocessors	Suit for alleged copyright infringement of 8080/86
INTEL CORP. v. SEEQ, Inc., Cal. Super. Ct., No. P39135 (1981-82)	E ² PROMS	Suit for alleged misappropriation of trade secrets
INTERSIL, INC. adv. Raytheon Corp., Cal. Super. Ct., No. 243795 (1975-76)	Bipolar manufacturing process	Suit for alleged misappropriation of trade secrets
IBM CORP. adv. American Republic Ins. Co., S.D. Iowa, No. 77-383-2 (1977-79)	IBM 3330 computer	Suit for alleged misrepresentation relative to pricing
IBM CORP. adv. California Computer Products, Inc., 613 F.2d 727 (9th Cir. 1979)	Computer disk drive components	Suit by CalColmp for alleged monopolization; suit by IBM for alleged use of trade secrets
IBM CORP. v. Catamore Enterprises, 548 F.2d 1065 (1st Cir. 1976), cert. denied, 431 U.S. 960 (1977)	IBM computer systems	Suit for alleged failure of computer system to operate in accordance with representations
IBM CORP. adv. Kuo, D. Ariz., No. 86-331-TUC- ACM (1985-86)	Disk drive technology	Suit for alleged misappropriation of proprietary documents
IBM CORP. v. Motor Replacement Co., D. Ariz., No. 69473-Phx- WEC (1971)	Systems engi- neering services	Suit for alleged violation of agreement to provide bundled services and to declare a class action therefor

<u>Client, Matter and Any Reported Decision</u>	<u>Technology or Product Involved</u>	<u>Nature of Case</u>
MDS QANTEL adv. Computer Systems Engineering, Inc., 740 F.2d 59 (1st Cir. 1984)	Qantel SOLUTIONS software	Suit for alleged breach of contract related to alleged defective products
NATIONAL SEMICONDUCTOR CORP. v. Linear Technology Corp., Cal. Super. Ct., No. P28633 (1981)	Linear IC's	Suit for alleged misappropriation of trade secrets
RAYTHEON CORP. adv. CVD, Inc., 769 F.2d 842 (1st Cir. 1985)	Chemical vapor deposition process for production of zinc sulfide and zinc selenide, processed into high-precision optical mate- rials for use as windows and infrared imaging systems, includ- ing specially designed vacuum furnaces oper- ating at high temperatures	Suit for alleged violation of trade secrets and antitrust counterclaims by CVD
ROLM CORP. v. Plessey Telecommunications, Ltd., N.D. Cal., No. C83 0740 WAI (1982-83)	Computerized digital tele- phone switch (CBX) and related telecom- munications equipment and computer software	Suit for alleged violation of copyright and trade secrets

Senator LEAHY. Senator Metzenbaum?

Senator METZENBAUM. Jack, let me just ask a couple of questions.

The proponents of this bill claim that there is a great diversion between the antitrust laws and intellectual property laws. Do you recognize this kind of a distinction?

Mr. BROWN. I do not. It seems to me that the matter of patent law, copyright law, trade secret law, all those have developed and are not at all adversely impacted by the sound development of anti-trust law.

There are occasions where patents have been held to be a sham device for price-fixing or unlawful output restrictions. There have been occasions, and I know of one, where a know-how license, a trade secret license, combined with a patent license—and those are not at all unusual; in fact, they are quite common—where the licensor claimed, many, many years after expiration of all of the patents that the know-how license continued on in effect forever and prevented all of the licensees, which were everyone in the industry, from ever developing competing technology.

That is the kind of misuse of the license that the courts ought to address under the antitrust laws. That is not inconsistent with giving proper credit and acknowledgement to intellectual property laws. I think it is quite consistent in order to prevent abuses.

Senator METZENBAUM. Well, they claim that the antitrust laws have been applied to disfavor the licensing of intellectual property as compared to the licensing of other property. Do you see any distinction there?

Mr. BROWN. I do not think they can make out a case of that sort. They keep referring back to the *Data General* case, and I have addressed that in the written statement, and I could address it further. I do not think that is a case that needs concern anyone in the high-technology industries. The courts are working that problem out, and it could be addressed very nicely with a specific bill, if one is desired, as to the presumption of market power.

Senator METZENBAUM. You represent a number of companies that hold patents. The argument is made that this would help our international competitiveness. True or false, in your opinion?

Mr. BROWN. Well, I think that is false. The fact is that we ought to recognize it; that better than 42 percent of all the patents that are applied for currently, in recent years are applied for by foreign companies.

The problem with competing with the foreign companies is that we have to open up their markets, and particularly the market in Japan and some other markets in Asia. No one can do business successfully today unless he can sell both in the United States and in Asia and indeed also in Europe. That is a fact, at least in the high-technology businesses.

If we invite retaliation from the foreign companies with respect to closing out their markets even further from entrance by American companies—which I think this kind of law would do—I think we would be damaging our innovative companies. We have to protect intellectual property in this country and see to it that those protections are afforded in other countries as well; but we certainly do not want to invite the foreign competitors to engage in further

predatory activities or anticompetitive activities, which this kind of a law might well do.

Senator METZENBAUM. Thank you, Mr. Brown.

Thank you, Mr. Chairman.

Senator LEAHY. Thank you.

Mr. BROWN. I should say in further response, Senator Metzenbaum, that I am appearing here today solely on my own behalf—I hope that is understood—not representing anyone in particular. These are my own views.

Senator METZENBAUM. Not even your wife, Susan?

Mr. BROWN. I am not even sure my wife would agree with anything I had to say. [Laughter.]

Senator METZENBAUM. Thank you, Mr. Chairman.

Senator LEAHY. Thank you, Senator.

Mr. Taylor, why don't we go to you, and then hear from Mr. Susman—and then I will yield first to Senator Specter for questions, and then I will ask my questions.

STATEMENT OF ROBERT P. TAYLOR

Mr. TAYLOR. Thank you, Mr. Chairman.

My name is Robert P. Taylor, and I am appearing here on behalf of the American Bar Association. I have been antitrust lawyer for about 20 years in San Francisco, with the firm of Pillsbury, Madison and Sutro.

The American Bar Association, through its section on antitrust law, has taken an interest in the issues raised by S.438. We first looked at these issues back in 1983-84 in connection with the National Cooperative Research Act of 1984 which dealt with research joint ventures. We took a look at the same principles again in 1986, in connection with H.R. 4070, and we still endorse the underlying principles of Senate bill 438. A copy of our 1984 report is in the record.

I disagree with my colleague, Mr. Brown, in terms of the desirability or the importance of maintaining per se rules in this area. The per se rule of law as applied in antitrust cases is basically a rule of judicial convenience. It is a rule that says that we are going to exclude certain kinds of evidence because we know in advance that even after all the evidence is in, we are going to have an arrangement that restrains trade unreasonably and therefore will violate the antitrust laws. In my view, per se rules constitute an overly simplistic and wooden approach to antitrust analysis that does not work very well when complex commercial considerations are involved.

The licensing of technology, particularly the licensing of patents in complicated commercial situations, is inordinately difficult to apply per se rules to across-the-board, and that is what we are talking about. The commercial considerations are very complex, and per se rules inhibit the ability of technology owners to come up with workable schemes for the exploitation, development, commercialization of their technology---

Senator SPECTER. Excuse me, Mr. Taylor, may I interrupt you at that point?

Mr. TAYLOR. Yes, sir.

Senator SPECTER. The per se rules have been established because of the conclusion that they do constitute an antitrust violation. And obviously, the rule of reason gives latitude to engage in certain practices.

Now, why is your line different to make this fundamental change? What is the essential difference in this proposal which justifies abandoning the per se requirement for rule of reason?

Mr. TAYLOR. Senator, I am not certain that I can describe all of the various licensing arrangements where this legislation is likely to have much of an effect.

The tying area is one that will be changed. Now, tying is something of an unusual antitrust concept in the way it is applied in the courts because, while the courts say that they use per se rules to analyze tying arrangements, in fact they use a rule-of-reason analysis through different analytical techniques. The plaintiff in a tying case, for example, has to prove market power, and yet the proof of market power, the proof of the effect of a particular arrangement in a relevant market, is one of the basic hallmarks of a rule-of-reason analysis. It is not a per se rule at all.

The problem that you have where the tying product is a patented process, a patented article or a copyright is the courts say that they simply are going to relieve the plaintiff from any need to prove market power. That is a real per se rule and you end up with a circumstance where the ability of a licensor to commercialize his product is simply not there.

I have seen it in my own practice, that many people who develop technology for use in a particular area of commerce, and maybe they are not a company with sufficient developed marketing potential to market their technology, or it may be a company without sufficient capitalization to manufacture something that is needed to develop the technology—they go looking for some commercially feasible arrangements, alternative arrangements, to license it. But when their antitrust lawyers say you are running some serious risks here if you pursue any one of these particular arrangements, they abandon the idea.

It is a very inhibiting effect.

Senator SPECTER. Well, I can understand that it is an inhibiting effect, and I can understand that if the rule were changed, it would make it easier to market intellectual property—and you may be right. But every time we relax the antitrust laws, we do so without fully comprehending all of the consequences—not that we fully comprehend all the consequences of anything we do, necessarily. But the thrust of my question goes to why is intellectual property different from other commercial transactions? Why shouldn't we, for the same arguments you advance, eliminate per se rules generally and go the reasonableness route?

Mr. TAYLOR. I think to some extent the courts have recognized that there is wisdom in doing that very thing. Certainly, there has been a relaxation of the per se rules, except in the intellectual property area, in recent years. The approach taken by the Supreme Court—

Senator SPECTER. Excuse me. Are the cases more restrictive on intellectual property than on other matters?

Mr. TAYLOR. They are more restrictive for two reasons, Senator. First, and as I have already noted, the courts presume market power whenever there is intellectual property involved. This pervades even the rule-of-reason cases. Second, the law is not developing as rapidly in the intellectual property area as in antitrust generally. The number of intellectual property cases that make their way to the Supreme Court is minuscule by comparison with the rest of the antitrust cases, and this leaves the lower courts to be guided by a large body of case law that is hostile to the very concept of intellectual property. If you start in 1912 and work your way up through the fifties and early sixties, you find an increasingly hostile judicial sentiment expressed in the opinions of the Supreme Court toward any commercialization of intellectual property that places limits on the activities of the licensee. That policy hit its high point with Justice Douglas' decisions in the *Mercoïd* cases in the forties, but it started back in the 1910s, and it continued right on up until the seventies. And the problem that practitioners have is there are not enough of these kinds of cases that make their way into the courts to bring the body of intellectual property law, the intellectual property/antitrust interface, current with the rest of antitrust thinking. You have a lot of outdated decisions that practitioners and courts rely on for guidance. That is the principal concern that I see.

Senator SPECTER. Thank you.

Mr. TAYLOR. The ABA also endorses those aspects of S. 438 which would remove trebling from private actions brought on intellectual property licenses. We start with the proposition that trebling is most appropriate in those kinds of cases that involve hardcore antitrust violations—price-fixing, market division, boycotts, rigged bidding, and that sort of thing. You simply do not have the same motivation for trebling provisions when you talk about commercializing technology.

For example, one of the principal arguments advanced for why we need trebling is to create an incentive to discover or unearth what otherwise would be clandestine arrangements. With intellectual property licensing, where you have adversaries on both sides of the license, this is less of a concern. If there is something anti-competitive about a licensing arrangement, the licensee knows it the day that he signs the agreement and has every incentive to challenge it. You just do not have the same concerns here that you have in connection with other antitrust types of problems.

One aspect of the bill which is addressed in my prepared remarks and which I would call to the attention of these two subcommittees has to do with the misuse doctrine. I think that it is unlikely that any real relief from the overapplication of the antitrust laws to the exploitation of technology is likely to be forthcoming unless we also address the doctrine of patent misuse, a companion doctrine of law—rooted in the antitrust laws but not requiring an antitrust violation for its application—and which causes courts to find patents and copyrights unenforceable. I note with some encouragement that the omnibus trade bill, the Senate version of H.R. 3, does provide relief on this score.

Senator LEAHY. Thank you.

Incidentally, misuse is going to be addressed in the trade bill, should we ever get to that voluminous piece of work.

[Mr. Taylor's statement follows:]

Testimony of Robert P. Taylor
on behalf of
The American Bar Association

Testimony given October 20, 1987
at a joint hearing of the
Senate Judiciary Committee's
Subcommittee on Technology and the Law
and
Subcommittee on Antitrust, Monopolies and Business Rights
with respect to

Senate Bill 438
entitled
"Intellectual Property Antitrust Protection Act of 1987"

I am here to state the views of the American Bar Association with respect to issues raised by Senate Bill 438 dealing with the application of the antitrust laws to the licensing of intellectual property. Enclosed is a copy of a resolution approved by the ABA House of Delegates and the accompanying Report of the Antitrust Section dated February 3, 1984. Although these were specifically addressed to an earlier bill in an earlier Congress, the rationale of the ABA position is fully applicable to S.438. The Antitrust Section reconfirmed its position in 1986, supporting H.R. 4070 and other legislation with objectives identical to S.438.

Section 2 of S.438 would preclude the application of per se rules of antitrust illegality to licenses of patents, trade secrets and copyrights. The ABA supports such a provision. The licensing of new technology is extremely beneficial to society as a whole, because it increases the number of companies that can take advantage of an innovative or cost-saving discovery. Without licensing, such discoveries often remain proprietary to a single company.

Per se rules discourage licensing that would otherwise occur, because they condemn commercially useful licensing arrangements without regard to whether those arrangements actually restrain trade. The abandonment of per se rules in accordance with S.438 would not mean that

licensing agreements which in fact restrain trade will no longer be subject to judicial redress. The change merely insures that a licensor will be permitted to offer evidence in support of his licensing scheme, protected from having the scheme summarily struck down in the interest of judicial convenience.

Section 2 does not represent a major change in the law. The courts already proceed under a rule of reason in the vast majority of situations involving antitrust challenges to patent licenses. For the most part, Section 2 is needed more to overcome cautionary perceptions on the part of patent owners and their lawyers, and thereby encourage licensing, than to bring about any significant change in the substantive law.

The one area in which Section 2 may change existing law relates to the antitrust concept of tying. In general, tying is defined as the sale of one product (the "tying product") conditioned upon the willingness of the buyer to purchase a second product (the "tied product") from the seller. To prevail in a tying case, the plaintiff normally must show that the seller possesses some degree of market power in the tying product and that a substantial amount of commerce in the tied product is restrained.*

* See, e.g., Northern Pac. R. Co. v. United States (1958) 356 U.S. 1, 5-6.

Tying has proven troublesome in cases where either a patent or a copyright is alleged to be the tying product, because the courts often presume the existence of market power whether or not it actually exists.** Section 2 would eliminate this presumption and require a showing by plaintiff that the patent or copyright creates actual market power. In this respect, the bill adopts the view of Justice O'Connor, concurring in Jefferson Parish Hosp. Dist. No. 2 v. Hyde (1984) 104 S.Ct. 1551, 1572 n.7, that where there are economic substitutes for a patented or copyrighted resource, tying is unlikely to restrain trade at all.

The adoption of S.438 would not undermine enforcement policies in cartel situations such as those involved in Timken Co. v. United States (1951) 341 U.S. 593 and United States v. Gypsum Co. (1948) 333 U.S. 364, because the dominant purpose of a cartel is to restrain trade, not to license technology. This very distinction was used by the Supreme Court in Timken to reject arguments by the defendants that their horizontal market division was justified as ancillary to a valid license of the "Timken" trademark:

"Appellants' premise that the trade restraints are only incidental to the trademark contracts is refuted by the District Court's finding that the 'trade mark provisions * * * were subsidiary and secondary to the central purpose of allocating

** See, e.g., United States v. Loew's, Inc. (1962) 371 U.S. 38; International Salt Co. v. United States (1947) 332 U.S. 392.

trade territories.' Furthermore, while a trade-mark merely affords protection to a name, the agreements in the present case went far beyond the protection of the name 'Timken' and provided for control of the manufacture and sale of anti-friction bearings whether carrying the mark or not" (341 U.S. at 598-99).

Similarly, in Gypsum, the Supreme Court found a price-restrictive licensing arrangement unlawful, because the licensees themselves participated in formulating and imposing the restrictions on one another, and because the dominant purpose of the entire arrangement was anti-competitive:

"[The General Electric decision] * * * gives no support for a patentee, acting in concert with all members of an industry, to issue substantially identical licenses to all members of the industry under * * * which the industry is completely regimented, the production of competitive unpatented products suppressed, a class of distributors squeezed out, and prices on unpatented products stabilized" (333 U.S. at 400).

Even if a court were to construe S.438 as requiring a rule of reason analysis in cases similar to Timken and Gypsum, the recent decision of the Supreme Court in F.T.C. v. Indiana Federation of Dentists (1986) 106 S.Ct. 2009 demonstrates that a rule of reason analysis--in situations where there is a plain anticompetitive purpose--should not present the courts with any serious problem. The Court noted, for example:

"Application of the Rule of Reason to these facts is not a matter of any great difficulty. * * * While [a refusal by the respondent dentists to provide patient x-rays to insurance carriers] is not price-fixing as such, no elaborate industry analysis is required to demonstrate the anti-competitive character of such agreement" (106 S.Ct. at 2018, citing Society of Professional

Engineers v. United States (1978) 435 U.S. 679, 692).

Sections 3(a) and 3(b) of the bill would abolish the use of trebling and thus limit antitrust awards for injuries caused by licensing practices to single damages. The ABA supports this provision, because it will facilitate the licensing and transfer of technology. Many practitioners and patent owners have called attention to the "chilling effect" which the fear of treble damages and the fear of meritless (but costly) litigation spawned by the prospect of treble damages can have upon the willingness of owners to license new technology.

The principal policy objectives normally offered as reasons for preserving the treble damage remedy in antitrust cases are (1) to encourage the detection of unlawful agreements and (2) to deter unlawful conduct through punitive measures. Both of these considerations are less appropriate when applied to licensing than to other types of agreements. There is less need to encourage detection, because a license by its very nature is an open agreement between potential adversaries, subject to attack by the licensee at any time, and also subject to discovery in any proceeding brought to enforce the property right. Deterrence should be less of a concern in this connection, because unlike many of the agreements subject to the

antitrust laws, licensing has great potential for being procompetitive.*

One aspect of the legislation requires comment-- the absence of any provision which addresses the so-called "misuse doctrine." This doctrine, which is rooted in antitrust principles but which does not require an antitrust violation for its operation, overhangs nearly every enforcement action brought by a patent owner. The misuse doctrine creates an equitable defense to an enforcement action, whether for infringement or to collect royalties, rendering the entire property right essentially void. The doctrine is normally applied on a per se basis whenever it appears that the owner has tried to influence commerce outside the precise temporal or physical scope of his patent.

* The Supreme Court, in United States v. United States Gypsum Co. (1978) 438 U.S. 422, 441, 441-442 n.17 warned of the danger of "overdeterrence" in applying the antitrust laws to commercial behavior:

"[There exists] the distinct possibility of overdeterrence; salutary and procompetitive conduct lying close to the borderline of impermissible conduct might be shunned by businessmen who chose to be excessively cautious in the face of uncertainty regarding possible exposure to * * * punishment for even a good-faith error of judgment.

* * *

[W]here the conduct proscribed is difficult to distinguish from conduct permitted and indeed encouraged, as in the antitrust context * * * excessive caution * * * will not necessarily redound to the public's benefit."

It is not at all apparent that the misuse doctrine serves any useful purpose. The doctrine is not needed for compensatory reasons, because anyone actually injured by an anticompetitive licensing practice still has an antitrust remedy--damages, injunctive relief, and attorneys' fees--to redress that injury.

The misuse doctrine limits significantly the range of options available to a patent owner seeking to commercialize new technology, because many complex transactions simply will not fit into its narrow mold. Often, for example, the owner of new technology is a seller of unpatented equipment or consumables whose only incentive to develop new technology in the first place is to increase sales of these unpatented products. The misuse doctrine forbids any licensing or marketing scheme designed to carry out such a purpose, even though the net effect would be procompetitive and socially useful.

The recent decision of the Court of Appeals for the Federal Circuit in Senza-Gel Corp. v. Sieffhart (Fed.Cir. 1986) 803 F.2d 661 illustrates this point. There the court affirmed a misuse holding, thus rendering the patent unenforceable, because the owner of a patented process had made the process available to others only through the purchase of a machine which performed the steps of the process. The court appeared to recognize that its

decision was not compelled either by policy or economics, but the court nevertheless thought itself constrained to follow years of precedent as to misuse principles:

"We are bound to adhere to existing Supreme Court guidance in the area until otherwise directed by Congress or the Supreme Court" (803 F.2d at 667-668, n.5).

The ABA supports changing the misuse doctrine to require that the conduct in question be shown to violate the antitrust laws. Such a change is consistent with the underlying purpose of S.438.* Indeed, without that change, licensing practices which would be permitted and encouraged by the abolition of per se rules, as S.438 is designed to do, may still be in danger of being held to constitute misuse. In United States v. Studiengesellschaft Kohle, m.b.H. (D.C.Cir. 1981) 670 F.2d 1122, the District of Columbia Circuit rejected an antitrust challenge by the government and upheld a license restriction on the use of unpatented products made by a patented process. The court applied a rule of reason analysis to find the use restriction procompetitive in that it facilitated licensing that otherwise could not have occurred. The same court, however, only a year earlier had held an almost identical restriction to constitute misuse, thereby rendering the patent

* The inclusion of such a provision in the Senate version of H.R. 3 is consistent with the views of the ABA.

unenforceable (see Robintech v. Chemidus Wavin, Inc. (D.C.Cir. 1980) 628 F.2d 142, 146-149). Few patent owners, in the face of such conflicting holdings, can confidently employ such a license restriction, even though that restriction might be beneficial.

We appreciate the opportunity to be heard on these issues. We are prepared to respond in writing to any questions propounded by the Committee.

Robert P. Taylor
Finance Officer,
Section of Antitrust Law
American Bar Association

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AMERICAN BAR ASSOCIATION
SECTION OF ANTITRUST LAW

REPORT TO THE HOUSE OF DELEGATES

RECOMMENDATION

BE IT RESOLVED, that the American Bar Association supports the passage of Titles II through V of the National Productivity and Innovation Act of 1983 (S. 1841 and H.R. 3878) (the "Act"), subject to the modifications and qualifications described below.

(a) FURTHER RESOLVED, that the American Bar Association supports the provisions of Title II of the Act which provide that no joint research and development program shall be deemed illegal per se under the antitrust laws and that damages in lawsuits that are based on conduct that is part of a joint research and development program shall be limited to actual damages. FURTHER RESOLVED, that the American Bar Association opposes the provisions of Title II of the Act that would require notification of joint research and development programs.

(b) FURTHER RESOLVED, that the American Bar Association supports the provisions of Title III of the Act which provide that agreements to convey rights to use, practice or sublicense intellectual property shall not be deemed illegal per se under the antitrust laws and damages in lawsuits that are based on intellectual property agreements shall be limited to actual damages. FURTHER RESOLVED, that the American Bar Association proposes that the Act be amended so as not to apply to agreements to convey the right to use trademarks.

(c) FURTHER RESOLVED, that the American Bar Association supports the provisions of Title IV of the Act which provide that a claim of patent or copyright misuse must be based on conduct which violates the antitrust laws and proposes that the Act be amended to clarify that the party asserting misuse need not satisfy antitrust standing or antitrust injury requirements.

(d) FURTHER RESOLVED, that the American Bar Association supports the provisions of Title V of the Act which provide that process patentees may prevent others from using or selling products produced by the patented process to the extent that this Title would allow U.S. process patentees to prevent imports into the United States of products produced abroad in violation of a U.S. process patent.

AMERICAN BAR ASSOCIATION
SECTION OF ANTITRUST LAW
REPORT
TO THE HOUSE OF DELEGATES

I. INTRODUCTION

In September 1983, President Reagan proposed legislation entitled the "National Productivity and Innovation Act of 1983" (the "Act"). The Act has been introduced in the Senate as S. 1841 and in the House of Representatives as H.R. 3878.* The proposed legislation is intended to modify the antitrust, patent and copyright laws in a manner that will enhance the nation's productivity and the ability of U.S. industry to compete in the world market. The legislative package is part of a larger Administration program designed to encourage private sector research and development activities by improving the economic and legal climate for such efforts.

The Section of Antitrust Law of the American Bar Association endorses proposed legislation and other measures designed to accomplish these objectives. In particular, the Antitrust Section supports the passage of those elements of the Act which are reasonably calculated to promote legitimate research and development activities by clarifying the standards under which legality of such activities will be judged and modifying those statutes and doctrines which, as actually applied or as perceived, may tend unduly to inhibit such activities. This Report will set forth the Antitrust Section's position respecting the principal elements of the Act.

* The Administration's bill and the Administration's analysis of the bill, as reported in 43 Antitrust & Trade Regulation Report (BNA) 397-401 (September 15, 1983), are attached as Appendix A to this Report. Copies of S. 1841 and H.R. 3878 are attached as Appendix B and Appendix C, respectively.

II. SUMMARY OF RECOMMENDATIONS

A. The Antitrust Section supports the passage of legislation (in particular, Title II of the Act) which provides that no joint research and development program shall be deemed illegal per se in any action brought under the antitrust laws, and which limits damages in actions brought under Section 4 or Section 4C of the Clayton Act to actual damages in cases based on conduct that is part of a joint research and development program. The Antitrust Section opposes the notification provisions contained in Sections 203 and 204 of Title II, however, and it does not believe that the detrebling provisions should be conditioned on the specified notification procedure. The notification provisions should be deleted from the Act.

B. The Antitrust Section supports the passage of legislation (in particular, Title III of the Act) which provides that agreements to convey rights to use, practice, or sublicense patented inventions, copyrights, trade secrets, know-how, or other intellectual property shall not be deemed illegal per se in actions under the antitrust laws, and which limits damages to actual damages in actions based on such agreements brought under Section 4 or Section 4C of the Clayton Act. The Antitrust Section believes, however, that Title III should be amended to exclude agreements to convey rights to use trademarks from the coverage of the Title.

C. The Antitrust Section supports the passage of legislation (in particular, Title IV of the Act) which provides that conduct cannot be found to constitute patent or copyright misuse on the basis of its possible effect on competition unless such conduct violates the antitrust laws. Title IV should be amended, however, to clarify that the party asserting misuse need not satisfy antitrust standing or antitrust injury requirements to be entitled to raise the misuse defense.

D. The Antitrust Section endorses the resolution relating to process patent legislation adopted by the Section of Patent, Trademark and Copyright Law of the American Bar Association at its 1983 Annual Meeting. The Antitrust Section therefore supports the passage of legislation (in particular, Title V of the Act) which grants process patentees the right to exclude others from using or selling products made by the patented process to the extent that such legislation applies to products made by the patented process which are imported into the United States.

III. DISCUSSION

A. Title II: Joint Research and Development Programs

Title II of the Act is intended to promote research and development activities by clarifying the antitrust standards by which the legality of joint research and development programs will be judged. Title II provides that no joint research and development program shall be deemed illegal per se under the antitrust laws, thus ensuring that "rule of reason" analysis will be applied in assessing the legality of such programs. The proposed legislation defines a "joint research and development program" to mean theoretical analysis, exploration or experimentation, or the extension of scientific knowledge into practical application, such as the development of prototypes. Under Title II, such programs may also include the establishment of research facilities, the collection and exchange of research information, the prosecution of patent applications, the granting of licenses and any other conduct reasonably necessary and appropriate to such program.

The Antitrust Section endorses the Administration's proposal that the per se standard be deemed inapplicable to joint research and development programs. The proposed legislation, if enacted, would not change the substantive standard for determining the legality of joint research and development programs. Rather, the legislation would merely codify the existing "rule of reason" standard that has been consistently applied in assessing the legality of such programs. It does, however, eliminate the possible application of inconsistent legal standards and any corresponding uncertainty (whether or not well-founded) as to the precise standard to be applied. In so doing, the proposed legislation will promote legitimate joint research and development programs.

The Antitrust Section also supports the passage of Section 203 of Title II, which limits damages to actual damages (plus prejudgment interest, court costs and attorneys' fees) in actions brought under Section 4 or Section 4C of the Clayton Act based on conduct that is part of a joint research and development program. Title II would modify the existing statutory requirement that plaintiffs' damages be trebled in all actions brought under Sections 4 and 4C of the Clayton Act.

The Antitrust Section supports the damage limitation provisions of Title II because the existing treble damage requirement may tend to overdeter legitimate joint research and development activities. The actual damages approach contained in Title II would eliminate this overdeterrent potential, yet allows victims of unlawful practices to recover their actual damages. Moreover, Title II preserves antitrust plaintiffs' ability to recover "the cost of suit, including a reasonable attorney's fee." Nor does the proposed legislation affect a plaintiff's ability to seek appropriate injunctive relief pursuant to Section 16 of the Clayton Act. Thus, Title II's modification of the existing treble damage requirement will promote legitimate joint research and development activity while permitting the effective prosecution of meritorious antitrust claims and providing the victims of unlawful practices with compensation for any actual damages sustained.

Title II conditions the availability of its detrebling provisions upon the filing of a prescribed notification disclosing the joint research and development program with the Attorney General of the United States and the Federal Trade Commission. The notification procedure is set forth in Section 204 of Title II.

The Antitrust Section opposes this notification requirement and recommends that Title II be amended to delete the notification provisions contained therein. The disclosure option provided for in Sections 203 and 204 of Title II is undesirable for several reasons. First, advance disclosure of the features of a research and development joint venture is not needed to protect third parties as long as single damages remain available to compensate persons who may later be injured by the operation of the venture. Second, public disclosure may deter companies from taking advantage of the detrebling provisions of the Act and may in fact present a greater disincentive to the formation of research and development joint ventures than do current perceptions of possible antitrust exposure. Third, the disclosure provision -- with publication requirements, withdrawal rights and confidentiality procedures -- adds unnecessary complexity to the bill, and may lead to the imposition of a regulatory burden on the Antitrust Division, the Federal Trade Commission and the business community. Fourth, non-disclosure of the joint research and development program could conceivably give rise to a negative inference respecting the legality of the program in subsequent litigation despite the fact that the participants had

independent business reasons for opting against the notification procedure.

More fundamentally, the disclosure provision does not appear to be necessary to protect against potentially anticompetitive conduct. The extremely limited number of cases concerning research and development joint ventures and of government enforcement actions challenging joint research activity suggests that most research and development joint ventures do not pose such serious anticompetitive risks as to warrant a separate advance notification procedure. Correspondingly, experience in the field provides no rational basis for conditioning detrebling upon advance notification.

For the foregoing reasons, the Antitrust Section recommends that Title II be amended to delete the notification provisions contained therein.

B. Title III: Intellectual Property Licensing Arrangements

Title III of the Act would add a new Section 27 to the Clayton Act, providing that "[a]greements to convey rights to use, practice, or sublicense patented inventions, copyrights, trade secrets, trademarks, know-how, or other intellectual property shall not be deemed illegal *per se* in actions under the antitrust laws." Title III also would limit damages in antitrust cases based on such agreements to actual damages, plus prejudgment interest.

The Antitrust Section supports the passage of Title III of the Act, but believes that agreements to convey rights relating to trademarks should be excluded from the legislative proposal. Subject to this qualification, the Antitrust Section believes that Title III will promote research and development activity and access to the fruits of such activity by other parties.

Title III complements Title II by placing single-firm licensing activities on an equal footing with joint research and development programs with respect to the appropriate antitrust standard to be applied and the damages allowable where challenged practices are found to be anticompetitive. Single-firm research and development activities and licensing practices incident thereto should not be subject to a more exacting standard, nor subject to a higher level of potential exposure, than joint research and development programs.

Moreover, the Antitrust Section supports the passage of Title III (subject to the exclusion of trademark licensing arrangements) for reasons independent from its logical nexus with Title II. The ability to license proprietary technology is an important component of a legal system conducive to innovation. See U.S. Department of Justice, Detailed Analysis of Antitrust Legislative Reforms Proposed by the Department of Justice (March 1983). Impediments to licensing arrangements, including the perceived antitrust risks incident to such arrangements, can deter research and development activities by reducing the commercial attractiveness of R&D efforts. Further, such impediments can limit access to proprietary innovations developed by other parties, thereby reducing the potential for more widespread commercialization of the innovation and limiting the number of persons engaged in searching for improvements thereon.

By ensuring that the legality of intellectual property licensing arrangements will be judged under rule of reason analysis, Title III of the Act promotes reasonable, commercially attractive licensing arrangements. Similarly, by limiting antitrust damages based on such arrangements to actual damages, Title III eliminates the overdeterrent potential of the existing treble damage requirement.

It is essential to note that Title III will not allow practices which are proven to be anticompetitive to escape condemnation under the antitrust laws. Proscription of the per se approach will merely oblige the courts to receive evidence concerning the probable economic effects of a challenged practice before ruling upon the antitrust legality of the practice. Further, the remedial provisions contained in Title III, like the corresponding provisions in Title II, will permit the prosecution of meritorious antitrust claims and will provide the victims of unlawful conduct with compensation for their actual damages.

Finally, the provisions of Title III are limited to "[a]greements to convey rights to use, practice or sublicense patented inventions, copyrights, trade secrets, trademarks, know-how or other intellectual property." Title III therefore leaves undisturbed the per se rules and treble damage remedy available to plaintiffs arising out of other alleged violations of the antitrust laws. Thus, a naked agreement in restraint of trade would remain subject to the per se standard and the treble damage remedy even if a licensing agreement were adopted as a means of implementing the basic agreement, since the cause of action attacking the

basic agreement would not be "based" on the licensing agreement.

As proposed by the Administration, Title III would apply to agreements conveying rights to use trademarks as well as the other enumerated types of intellectual property. As previously noted, the Antitrust Section believes that Title III should be amended to delete the reference to "trademarks" in proposed new Section 27(a) of the Clayton Act and to expressly exclude trademarks from its terms. Unlike the other types of intellectual property listed in Title III, trademarks are legally protected indicators of origin which are primarily related to the marketing of goods, as opposed to research and development efforts. As a result, trademarks are not properly within the same technological innovation framework which supports the other provisions of the Act.

C. Title IV: Patent Misuse

Title IV of the Act would amend 35 U.S.C. § 271 to provide that enumerated patent practices cannot provide the basis for a finding of misuse or illegal extension of the patent unless such practices, in the circumstances in which they are employed, violate the antitrust laws. These practices include:

(1) licensing the patent under terms that affect commerce outside the scope of the patent's claims (e.g., requiring a licensee to purchase unpatented materials from the licensor, requiring a licensee to assign to the patentee a patent that may be issued to the licensee after the licensing arrangement is executed, restricting a licensee's freedom to deal in products or services outside the scope of the patent, requiring the licensee to become a licensee of a second patent);

(2) restricting a licensee of the patent in the sale of the patented product or in the sale of an unpatented product made by the patented process;

(3) obligating a licensee of the patent to pay royalties that differ from those paid by another licensee or that are allegedly excessive;

(4) obligating a licensee of the patent to pay royalties in amounts that are not related to the

licensee's sales of the patented product or an unpatented product made by the patented process;

(3) otherwise using the patent in a manner that allegedly suppresses competition.

Title IV would also enact corresponding amendments to federal copyright law under 17 U.S.C. § 501(a).

The Antitrust Section supports these proposed amendments to 35 U.S.C. § 271 and 17 U.S.C. § 501(a). The proposed modification of the misuse doctrine is a necessary element of the Act's overall purpose of encouraging intellectual property licensing and, correspondingly, investment in research and development activities. It would be inconsistent to limit damages for antitrust violations in the context of licensing arrangements, on the one hand, and yet leave undisturbed a misuse doctrine which confronts intellectual property holders with the prospect of being unable to enforce their patents or copyrights because of economic provisions in licensing agreements which do not even constitute antitrust violations. Moreover, the proposed limitation on the misuse doctrine, on its own merits, would represent a positive development on the context of the patent/antitrust interface.

At the outset, it should be noted that Title IV would not alter existing law with respect to the misuse doctrine as it applies to improper practices not related to competition (e.g., fraud on the Patent Office). Rather, Title IV would merely ensure that a meaningful economic analysis has been performed before a court properly may refuse to enforce a valid patent or copyright under the misuse doctrine as applied to practices which are allegedly anticompetitive.

In the patent/antitrust context, two basic lines of patent misuse cases have developed. The primary line involved efforts to use the patent to control commerce outside the scope of the patent claims. See, e.g., Morton Salt Co. v. G.S. Suppiger Co., 314 U.S. 488, reh. denied, 315 U.S. 826 (1942). The second principal line of misuse cases involved practices related to products covered by the patent. See, e.g., Ansul v. Uniroyal Inc., 448 F.2d 872, 880 (2d Cir. 1971); F.C. Russell Co. v. Comfort Equipment Corp., 194 F.2d 592, 596 (7th Cir. 1952).

In both lines of cases, the courts found the patent owners guilty of misuse essentially on the grounds that the challenged practices were anticompetitive in effect and, therefore, contrary to public policy. Indeed, in Morton Salt the Supreme Court's holding was expressly premised on its finding that the patent had been used "as a means of restraining competition." 314 U.S. at 493. See also Mercooid Corp. v. Minneapolis Honeywell Regulator Co., 320 U.S. 680, 684 (1943), reh. denied, 321 U.S. 802 (1944) ("The legality of any attempt to bring unpatented goods within the protection of the patent is measured by the antitrust laws not by the patent law.").

Although this aspect of the misuse doctrine is grounded in national economic policy as expressed in the antitrust laws, the courts have stated that various forms of allegedly "anticompetitive" conduct may constitute patent misuse despite the fact that the conduct does not violate the antitrust laws. See, e.g., Morton Salt Co. v. G.S. Suppiger Co., supra. As a result, these cases treat market power derived from patents more harshly than market power derived from other lawful means. For example, these cases would deny a patent owner the ability to enforce its patent on grounds of misuse even though the challenged conduct falls short of an antitrust violation, but an identical practice employed in the context of a know-how license might well be enforceable. Compare A. & E. Plastik Pak Co. v. Monsanto Co., 396 F.2d 710, 715 (9th Cir. 1968) with Robintech, Inc. v. Chemidus Wavin, Ltd., 628 F.2d 142, 146-49 (D.C. Cir. 1980).

The Antitrust Section believes this aspect of the misuse doctrine is undesirable and should be addressed by appropriate legislation. It is by no means clear that all practices by which a patent holder seeks fully to exploit its patent rights are necessarily anticompetitive in purpose or effect. In fact, this aspect of the misuse doctrine is inconsistent with sound competition policy because it can deter procompetitive or otherwise desirable conduct. Moreover, the doctrine may inhibit research and development investment by precluding commercially attractive licensing programs.

Where licensing activities contravene national competition policy as expressed in the antitrust laws, a finding of misuse should follow. On the other hand, conduct should not be condemned as patent misuse on economic grounds unless the conduct is inconsistent with the antitrust laws. Title IV codifies these principles, and the Antitrust Section supports this proposed modification of the misuse doctrine.

Title IV should be amended, however, to make clear that the proposed modification does not incorporate the antitrust requirements of standing or antitrust injury into the misuse doctrine. In other words, it should be made clear that the party asserting misuse need not satisfy antitrust standing and antitrust injury requirements to raise successfully the misuse defense. A finding of misuse should be supportable wherever the substantive quality of the conduct violates the antitrust laws without regard to whether the party asserting misuse could properly bring a private antitrust action on the basis of that conduct. The Antitrust Section therefore recommends that Title IV be amended to provide that the enumerated practices cannot provide the basis for a finding of misuse unless such practices "would be found to violate the antitrust laws if challenged by the Department of Justice."

D. Title V: Process Patents

Title V of the Act would amend 35 U.S.C. §§ 154 and 271 to expand the exclusive rights of a process patent holder to products made by the patented process. The proposed amendment to Section 154 grants to process patentees the right to exclude others from using or selling such products; the proposed supplementary amendment to Section 271 makes the use or sale of such products infringement.

Under existing law, a process patentee can prevent the use of the patented process by domestic manufacturers by means of an infringement action under 35 U.S.C. § 271, but he cannot prevent the use or sale of unpatented products made by the process. A manufacturer who employs a process outside the United States to produce unpatented products is not liable as an infringer of a United States patent on the process, despite the fact that the products are ultimately sold in the United States. University Patents, Inc. v. Questor Corp., 213 U.S.P.Q. 711 (D. Colo. 1981), citing Clairol, Inc. v. Brentwood Industries, Inc., 193 U.S.P.Q. 683 (C.D. Cal. 1976). As a result, a process patent owner does not have any civil remedy against a manufacturer who uses the process outside the United States to make products sold in the United States.*

Title V of the Act would close this gap in United States process patent protection by providing that the use or

* Although a limited form of relief may be available to the process patent owner through the United States International Trade Commission pursuant to 19 U.S.C. §§ 1337 et seq., the procedural hurdles, evidentiary burdens and limited relief available in USITC proceedings have rendered this avenue of redress largely ineffective.

sale of unpatented products of a patented process would constitute an infringement of the patented process. The Antitrust Section supports the passage of Title V to the extent that the proposed amendments to the Patent Code are necessary to provide process patent owners with an effective civil remedy against the importation into the United States of products manufactured in another country by a process patented in the United States.

The Antitrust Section is not prepared, however, to support this extension of a process patent owner's rights to situations in which the use of the process occurs in the United States. Under existing law, process patent owners already have a cause of action against persons using patented processes within the United States and such patentees, through discovery, have adequate means to determine whether the processes being used are within their patent grants. Thus, while the need for legislation with respect to foreign practice of patented processes is demonstrable, it is less clear that such a need exists with respect to domestic process use. Since Title V will expose retailers, distributors and users of unpatented products made by patented processes to charges of infringement, the Antitrust Section believes that the legislative response should be confined to those situations in which a clearly defined need for remedial legislation has been shown to exist.

In this regard, the Antitrust Section endorses the following resolution which was adopted by the Section of Patent, Trademark and Copyright Law at its 1983 Annual Meeting:

Resolved, that the Section of Patent, Trademark and Copyright Law favors in principle the enactment of legislation to provide that whoever imports into the United States or uses or sells in the United States a product made in another country by a process patented in the United States and made during the term of that patent shall be liable as an infringer.

The Patent, Trademark and Copyright Section's resolution embodies the notion that the legislative response to the process patent problem should be limited to imported products at this time, and the Antitrust Section concurs for the reasons discussed above.

IV. CONCLUSION

The Antitrust Section believes that the various provisions of the Act are reasonably calculated to promote

domestic research and development activities in a manner that is consistent with national competition policy as embodied in the antitrust laws. Subject to the suggested modifications and qualifications set forth in this Report, the antitrust Section supports the passage of the Act.

February 3, 1984

Richard W. Pogue, Chairman

Senator LEAHY. Mr. Susman, it is good to have you back here in the committee room. You look very familiar here, very comfortable here, and I think most people feel that way about you.

Go ahead, please.

STATEMENT OF THOMAS M. SUSMAN

Mr. SUSMAN. Thank you, Senator. It is a very different perspective from down here.

I believe it is especially appropriate to have these two subcommittees, the Antitrust and Technology subcommittees, meeting today on this legislation because, as has been suggested in the testimony today, there has historically been a tension between antitrust and intellectual property laws that protect and encourage technology development.

Tension in any relationship—marriage, or a relationship between two bodies of law—can be a healthy thing. It does not necessarily reflect a conflict that is destructive. Certainly, the antitrust laws and intellectual property laws have in common the desire to reward innovators and open markets to them. In this regard, S. 438 appropriately addresses these two bodies of law in a way to effect accommodation between them, to provide clearer rules and more rational objectives.

I am appearing today, as my testimony indicates, on behalf of Digital Equipment Corp. Digital has a special perspective on this subject for three reasons.

First, Digital is a large computer company, the second largest in the world, but it is the leading manufacturing of, as indicated in my statement and in Digital's literature, networked computer systems—not components, not memory chips, not disk drives—but computer systems, networked systems, solutions, environments. These words by definition conjure up the framework for tying allegations.

Second, Digital spends over 10 percent of its revenues on research and development. It has been a leading innovator in technology industries and protects its innovations through patents, copyrights, trade secrets, and registration under the Chip Protection Act, a law with which Chairman Leahy is intimately familiar, made possible by virtue of his efforts in the last Congress.

And third, Digital has been involved in litigation. That is not why we are here today. The case that I will very briefly describe is one that has been settled—a case in which Digital sued to protect an important patent in its home district in Massachusetts. An alleged infringer responded with the defense of misuse, that was alleged to render the patent unenforceable, and then a separate lawsuit, an antitrust lawsuit, was filed elsewhere. And where would you guess it was filed? You would be right if you guessed the ninth circuit. And Digital was unable to get the two cases consolidated in the first circuit. So it faced the cloud of the *Data General* opinion being applied, as will any national manufacturer who does business across the United States, and certainly internationally; any case can be brought into the ninth circuit. So we are not talking about a single aberrant decision; it will have its effect across the land.

I think it is important to set aside discussion of price-fixing and horizontal arrangements because we seem to have unanimity among our witnesses, among the bill's sponsors as well, on those subjects, and focus on nonprice issues. And let me do so in two ways.

First, I think it is important to revisit the question that Senator Specter and before him, Senator Metzenbaum, asked about treating intellectual property different from other products.

Interestingly, if we hark back to Mr. Brown's opening statement, he said that at least as to output limitations and market divisions, those are per se unlawful. Well, my reading of the law in the area is that they are per se unlawful when they involve intellectual property licensing. But I thought that *Schwinn* told us that certain kinds of market divisions, and subsequent cases told us that non-price vertical restraints, are almost always rule-of-reason cases.

So at least outside the tying area, I believe we will find that case law at best is clouded and probably often applies the rule of reason to nonintellectual property, but not to intellectual property cases.

And certainly the Justice Department took the position historically in its "nine no-no's" that licensing of intellectual property should be more harshly treated by the courts.

So then we get to tying, and tying is important in this area for the reasons that I indicated and certainly for the reasons illustrated by the machinery and explanation of Hewlett-Packard's representative here today.

Mr. Brown tells us in his statement and repeats in his testimony that tying inherently creates a barrier to entry. True, it does. That is like saying every contract is a restraint of trade. I mean, that is a lawyer's statement that typically is not very helpful. It is only unreasonable restraints of trade that are unlawful, and it ought to be only unreasonable barriers to entry that are unlawful. And that is the problem with tying: it is a per se offense, but not always, and not clearly so, and not predictably so.

As Mr. Brown points out himself, leading cases allow sound business justification, and he cites a couple of cases. Well, I had thought that the per se rule did not allow business justification and a balancing of the kind that the rule of reason allows. But that suggests that the courts, and certainly the commentators, appear to believe that we should look to the question of reasonableness and anticompetitive effect.

So, once we do that, then we are saying, well, not all tying is bad, not all tying is pernicious, not all tying should be unlawful—just tying where you do not have some business justification. And I say that brings us right to the door of the rule of reason. Although I suppose if Congress wants to make clear, not relying on 1960 and 1961 district court or lower court cases, but if Congress wants to make clear that there is a business justification to the defense of a tying allegation, I will say fine, we will work with you, we can draft legislation. An easier way to do that is to say it is a rule-of-reason case. The courts know how to deal with this test; we do not have to worry about unforeseen consequences when we simply say that this subject should be squarely within the rule of reason.

The law is changing; there is no question about that. Mr. Taylor made that clear. Mr. Brown's statement relating to the presump-

tion of market power, and even tying, suggests that we are in a period of change.

I do not believe, Mr. Chairman, that we can sit back and simply let the courts evolve the changes so that one of these days, the law will be as we are advocating it should be today. And I do not believe we should do so for a couple of reasons. One is that we are talking about high-technology products, products that have very short life cycles. The computer industry generally uses a 36-month life cycle from prototype to retirement or replacement; 36 months for high-technology products is certainly shorter than we can ever expect the law to evolve, in fact, shorter than the average antitrust case.

In the end, it seems to me, the Judiciary Committee would be out of business if it sat back and said let's let the courts take care of these problems. That is why the Antitrust Subcommittee and the Technology Subcommittee are such active and important places today.

It is important for Congress to provide some predictability, to provide some clarity, and most of all to provide some reasonableness. And, Mr. Chairman, your legislation would do just that. My testimony goes into some proposed amendments, and we would look forward to working with the subcommittees and their staffs toward molding this legislation into a form that would address the concerns expressed here today.

Thank you for the opportunity to testify.

[Mr. Susman's statement follows:]

TESTIMONY OF

THOMAS M. SUSMAN

ON BEHALF OF

DIGITAL EQUIPMENT CORPORATION

Chairman Leahy, Chairman Metzenbaum, and members of the Technology and Antitrust Subcommittees. I am appearing today on behalf of Digital Equipment Corporation in support of S. 438, the "Intellectual Property Antitrust Protection Act of 1987." I am a partner in the Washington Office of Ropes & Gray and represent Digital on the issues under consideration in these hearings.

We commend both Subcommittees for joining to consider the questions addressed by S. 438, which are among the most important facing the nation: How do we maintain a competitive domestic marketplace while keeping our industries competitive in the international arena? How do we improve industrial productivity and enhance innovation of American businesses? And, more specifically, how do we ensure that our court system responds to economic realities, and considers these broader issues, in its antitrust decisions?

S. 438 is not a panacea; it could not possibly provide the answers to all these questions. But it does propose an important part of the answer to them by encouraging innovation through the clarification of intellectual property rights within the established framework of intellectual property and antitrust law.

Digital Equipment Corporation

Let me take a few moments to provide the Subcommittees with a brief background on Digital Equipment Corporation.

With revenues last year of nearly \$9.4 billion, Digital is the second largest computer company in the world and the leading manufacturer of networked computer systems and associated peripheral equipment. Digital has over 110,000 employees worldwide and sales and manufacturing operations in the U.S. and 62 other countries, as well as every state. Digital is committed to a U.S. presence, reflected in a 10-year profile approaching 70% domestic employment.

Digital spends 11 cents of every dollar of revenue on research and development -- or over a billion dollars this year. It should thus come as little surprise that the integrity of Digital's intellectual property rights is critical to its competitive success.

One of the cornerstones of Digital's recent emergence as an industry leader has been the world-wide acceptance of its patented VAX computer family. The computer architecture forming the heart of the VAX was reduced to the size of a single microchip by Digital engineers in 1984. The "MicroVAX" chip was the first 32-bit computer processor-on-a-chip registered under the Semiconductor Chip Protection Act. The "VMS" software associated with the VAX computer is protected by copyright and trade secret law.

Antitrust Laws and Protection of Intellectual Property

Legal protection of intellectual property rights such as Digital's is essential if intellectual property owners are to recoup their costs and to invest heavily in the development of further technology. The patent and copyright laws, by recognizing intellectual innovations as property, protect those innovations against potential usurpers who are only too willing to appropriate innovative technology and take a free ride at the innovator's expense.

In the current volatile high technology environment, where products have a short market life, intellectual

property rights must be protected by clear laws that provide swift and effective relief against infringement. Any delay in litigation brought to enforce these rights will eventually work to the detriment of the intellectual property owner. In an industry where costly research and development often consumes three, five or ten years for a product whose competitive life cycle may be less than three years, protracted litigation may easily span the competitive life of the patent and destroy the patent owner's opportunity to recoup his or her investment.

The antitrust laws, like the intellectual property laws, encourage innovation in the marketplace and provide essential protection for intellectual property owners. While the intellectual property laws encourage innovation by rewarding the individual innovator, the antitrust laws encourage innovation by insuring that innovators are able to enter the market and that the market stays competitive.

Despite this consistency in the fundamental goals of intellectual property and antitrust laws, there is a common misperception that the two bodies of law are essentially in conflict. This misperception -- arising from the mistaken belief that intellectual property laws grant monopolies in the economic sense -- has led to discriminatory treatment of patents and copyrights under the antitrust laws. Licensing agreements involving patents or copyrights have been subject to particularly harsh scrutiny under the "per se" rule. This traditional judicial treatment discourages the distribution of intellectual property through licensing agreements, limits unreasonably the returns available to the innovator, and inhibits the development of new intellectual property by artificially restricting opportunities to market this property. S. 438 addresses these problems by proposing that agreements concerning intellectual property rights be judged by the "rule of reason" that forms the basis of

standard antitrust analysis, instead of by the "per se" rule that is ordinarily reserved for more pernicious and inevitably harmful conduct.

* * *

Need for S. 438

This legislation, as introduced, would reform one of three judicially created rules that limit unreasonably the rights of intellectual property owners. The first -- to which S. 438 is directed -- is the rule that agreements to convey intellectual property rights may be considered to be per se violations of the antitrust laws. The second is the rule that in antitrust cases the existence of a patent or copyright creates a presumption of market power; Senator Leahy has stated his intention to propose an amendment to deal with this problem. Third, there is a rule that certain anticompetitive conduct by patent owners that falls short of violating the antitrust laws may nevertheless render rights unenforceable under the doctrine of "misuse"; this is the subject of a reform amendment in Title 34 of the Omnibus Trade Bill (H.R. 3).

These three rules combine to make it more time-consuming, expensive, and difficult for holders of intellectual property rights to enforce those rights against infringers. And they do so with often irrational and unfair results. The following may be a typical example, at least in cases involving high technology companies and thus the sale of systems involving multiple "products."

In an action by a high technology company against an infringer of its intellectual property rights, the defendant will raise as a matter of course an antitrust counterclaim and the defense of patent misuse. The defendant's principal contention will be that the plaintiff's licensing or marketing practices constitute "tying" and are therefore per se unlawful under Section 1 of the Sherman Act and Section 3

of the Clayton Act. The defendant will also argue that these practices involve misuse of a patent or copyright.

Tying, Intellectual Property and the Per Se Rule. In general, an arrangement will be considered to constitute "tying" if it is shown that (1) there are two separate products or services; (2) there is a sale or agreement to sell one product or service "conditioned" on the purchase of another (the "tie-in"); (3) the seller has sufficient economic power in the market for the tying product to enable it to restrain trade in the market for the tied product ("forcing"); and (4) a not insubstantial amount of interstate commerce in the tied product is affected.

Northern Pacific Ry. Co. v. United States, 356 U.S. 1, 6 (1958). A few courts will entertain evidence of a "business justification" defense.

Because, under current law, the economic power required to support a tying charge will be presumed when the allegedly tying product is patented or copyrighted, in such a case the party asserting the tying counterclaim need not show any economic power to sustain its charge. The per se rule then operates to relieve the complaining party of the burden of showing the unreasonable anticompetitive effect that must be proved under rule of reason analysis. The per se rule and the presumption of market power thus combine so that the intellectual property owner's licensing or distribution activity may be held to violate of the antitrust laws, and the owner subjected to treble damage liability, without any showing of actual economic power or the unreasonable anticompetitive effect otherwise necessary to sustain such a charge.

This operation of the per se rule, by imposing antitrust liability without a finding of anticompetitive effect, proscribes licensing and distribution arrangements that not only may not be anticompetitive, but that may in fact have a

procompetitive effect. Although intellectual property, like other property, may be used in ways that violate the antitrust laws, patent licensing and distribution agreements are not inherently or inevitably anticompetitive. To the contrary, every patent licensing agreement has a procompetitive effect in that someone other than the patentee gains access to the technology protected by the patent. A patent owner who lacks the resources fully to exploit a patent on his or her own may be able, through licensing agreements, to gain additional return on an investment in the patent at the same time the general public benefits from the broader use of the patent. Licensing likewise provides essential opportunities for small entrants into the high technology market; it makes it possible for those firms or individuals to derive returns from patents that are comparable to those gained by large companies without licensing.

The per se rule, by condemning arrangements involving patents without proof of actual anticompetitive effect, fails to recognize the beneficial effects of many licensing agreements. Under the rule of reason standard proposed by S. 438, courts would be required to base a finding of an antitrust violation on actual market analysis and proof of a substantial anticompetitive effect. This bill would create no special interest exception to the antitrust laws: Under the proposed rule of reason analysis, licensing arrangements with actual anticompetitive effects would continue to be proscribed. Only licensing and marketing practices without substantially anticompetitive effects would, appropriately, no longer give rise to antitrust liability. Perhaps equally importantly elimination of the per se rule will remove the chilling effect that the potential for per se liability can have on beneficial, economically rational conduct on the part of intellectual property owners.

Presumption of Market Power for Patents & Copyrights.

The presumption of market power for patented and copyrighted products is, like the per se rule, a judicial short cut for imposing antitrust liability that results in disproportionately harsh treatment of patents and copyrights. The presumption of market power is an outgrowth of early decisions that confused the exclusive legal rights granted by the patent and copyright laws with the economic monopolies addressed by the antitrust laws. The presumption continues to be applied, although it has been widely recognized as inaccurate. As Supreme Court Justice O'Connor stated in her concurring opinion in Jefferson Parish Hospital District No. 2 v. Hyde, 466 U.S. 2, 38 n.7 (1984), "a patent owner has no market power in any relevant sense if there are close substitutes for the patented product." The Federal Circuit similarly recognized that "[T]he patent system, which antedated the Sherman Act by a century, is not an 'exception' to the antitrust laws, and patent rights are not legal monopolies in the antitrust sense of that word." American Hoist Derrick Co. v. Sowa & Sons, Inc. 725 F.2d 1350, 136" (Fed. Cir.), cert. denied, 105 S. Ct. 95 (1984).

Mere ownership of a patent or copyright does not convey market power. There may be no demand for the patented or copyrighted product. Or, there may be substitutable products on the market; the ability of the owner of the patented or copyrighted product to raise prices above a competitive level is limited by the existence of these substitutes. Yet, even in these circumstances, current law provides that market power sufficient to find an antitrust violation will be presumed. This should be changed by Congress. (Attached to this statement is a more extensive legal analysis of the presumption of market power and the need for legislative reform of this irrational doctrine.)

Patent Misuse. The doctrine of patent misuse further

tips the balance against the intellectual property owner. Patent misuse is an equitable doctrine that may be raised as a defense to an action to enforce a patent. The doctrine is grounded on the same misconceptions that gave rise to the per se rule and presumption of market power: That a patent provides its owner with market power and that any conduct "outside the scope of the patent" must be anticompetitive. If a patent owner has "misused" a patent monopoly by attempting to extend its power beyond the scope of the patent, courts will refuse to enforce the patent against an infringer.

Current law provides that even if the patent owner is found not to have violated the antitrust laws, he or she may be deemed to have "misused" the patent and will be denied relief for infringement. Application of this doctrine is unpredictable; the results it yields are often economically irrational; and it can even work to stifle procompetitive conduct. The Judiciary Committee unanimously approved legislation to address this problem in S. 1200, now pending in conference as part of the Trade Bill.

The combination of the per se rule, the presumption of market power, and the misuse doctrine operate against intellectual property owners to prejudice intellectual property rights at a time when they are of increasingly vital importance to the United States economy and its future growth. Digital supports S. 438 and urges that Congress also reform the law of patent misuse by approving Title 34 in the Trade Bill.

Proposed Amendments to S. 438

We would like to offer a few specific suggestions regarding S. 438 for the Subcommittees' consideration.

First: A new section should be added to S. 438 eliminating the presumption of market power in antitrust

cases involving patents and copyrights. Specific language to accomplish this objective has been provided to Subcommittee staff.

Second: We also would support making clear through a specific amendment that S. 438 does not apply to agreements to fix or maintain price levels.

Third: The words "or refusals" should be inserted after "Agreements" at the beginning of section 2 (page 1, line 7). This will clarify and emphasize the obvious principle that per se rules should not condemn a refusal to convey intellectual property rights; such a refusal is often alleged to effectuate some other form of nonprice restraint or to violate Section 2 of the Sherman Act.

Fourth: Proscription of the per se rule should apply not only to "agreements or refusals to convey" intellectual property rights, but also to "restraints on the resale of products that embody those rights" (to be added before "shall" on page 2, line 4). This will prevent the illogical, if not perverse, phenomenon of the bill's penalizing patent owners who manufacture their own products, as opposed to those who license their patents to others.

* * *

Conclusion

The per se rule, the presumption of market power, and the patent misuse doctrine as currently formulated impede the efforts of patent and copyright owners to enforce their rights and yet in no way further the antitrust law's objective of preventing anticompetitive market practices. By hindering harmless or even procompetitive activities, these legal rules actually conflict with the antitrust law's goals of encouraging free competition and vigorous, diversified markets.

The legal rights and protections offered intellectual property should provide powerful incentives for high

technology companies to innovate. The antitrust laws, rather than subjecting owners of patents and copyrights to stricter rules than are applied to owners of other property, should treat patents and copyrights on at least an equal basis with other property. S. 438, by providing that agreements to convey intellectual property rights shall be analyzed by the rule of reason, is an important step toward achieving this goal.

Digital supports enactment of S. 438, as amended along the lines we have suggested. I appreciate having the opportunity to express our views before these Subcommittees today.

Senator LEAHY. Thank you very much, and we will take up that offer. As we begin to draft some of the changes in this, we will ask you for your help.

I am struck by the fact that all three of you are extremely knowledgeable in this area, far more than I am. But I think if you each had the same client come before you with the same fact pattern and ask what licensing practices the courts currently are viewing as per se violations, I think you would probably give some differing responses.

I mention that to point out two things. One, the case law still is not settled. But if I were the head of a corporation, having to make tens of millions, hundreds of millions, possibly even billions of dollars of R&D decisions, I think I would sit there and say, well, do not give me lawyer-talk about what the law might be, even though that is what you would have to do. I have got to make a decision before the next board of directors meeting. We are going to commit \$250 million, \$300 million, \$400 million—whatever—we are going to commit a certain percentage of our budget to this. We may or may not open another plant to do R&D. We may go in. We may decide we want to take Japan, or some other country, on head-on in a particular thing—but what can we do?

You see, that is the thing that concerns me.

Let us just review a bit why companies tie their products. Mr. Brown, you say in your written testimony that it is to block other firms from entering the market and competing with them. I will ask each one of you, starting with Mr. Taylor and working across, is that the only reason?

Mr. TAYLOR. No. And if that is the purpose of a tie, then a court will not have any trouble finding it illegal under a rule-of-reason analysis.

The rules for protecting intellectual property are highly technical rules. And if you develop a machine, you may not be able to get a patent on the machine, but the machine may cause certain steps

to take place within its mechanisms so that you can get a patent on a process.

Under the current state of the law, if you develop technology, and you are a seller, for example, of chemicals, and you go out and find a new use for a chemical, you develop a process for using a chemical, or you develop a special process for making it more cheaply than anyone else, you are not in the business of selling technology; you are in the business of selling this chemical. And under the current state of the law, you cannot license other people to use your process and require that they buy the chemical from you that this process requires. And under at least some reading of the law, you cannot even license someone else to use a process to make a chemical for their own internal consumption and prohibit them from reselling that chemical.

So what the current state of the law does is simply inhibit the ability of someone who puts money into R&D and who develops a new technology, inhibit his ability to market it.

Senator LEAHY. Mr. Susman?

Mr. SUSMAN. It is certainly true, Mr. Chairman, that every tie blocks something in the way of competition. Suits are sold with buttons. If they were sold without buttons, other button-makers would sell more buttons, without having to sell suits. I do not recall seeing any tying cases involving suits and buttons. The consumer has a choice—he can buy multiple suits with multiple kinds of buttons; he can cut them off and sew on different buttons.

In technology arenas, the problem is certainly manifested in a more complicated and significant way, as we have seen in front of us—as I understood it from Mr. Feman, the health system that is being sold by H-P is not just the two pieces of equipment, but other monitors and lots of other kinds of equipment. I went to Digital's trade show this year and noticed that they do not divide things on component or product lines—you do not go into a room and see CPU's, into another room and see software on the shelves, into another room and see disk drives or memory boards, into another room and see buses and interconnections. You go in, and one area is health systems; one area is all office automation systems; another area is devoted to the automobile industry; another area has warehousing and retailing products.

That is the way these things are put together. That is the way they are sold. And it is a very competitive environment.

Now, if it is a competitive environment, and if a rule-of-reason analysis of the market and anticompetitive effect tells us that it is a competitive environment, then where does the antitrust law come in and say that that is not the way things should be; that you should have to sell your monitor or your chip or your memory or something else separate from everything else you have developed together with it?

If it is not a competitive environment, then the antitrust laws will bring the manufacturer up short—as well they should. And as the chairman has mentioned a number of times today, this legislation is assuredly not an antitrust exemption or providing any exceptions to the antitrust laws. They will continue to apply with full force.

Senator LEAHY. Mr. Brown, as your statement is the one that started this line of questioning, what would you like to say?

Mr. BROWN. I would like to say that the Senator has accomplished something that is quite difficult to accomplish outside this hearing room; he has brought three lawyers to come to precisely the same conclusion, with some different reasoning, perhaps. I did not really expect otherwise, because I think we do have a degree of agreement which is not generally acknowledged, and you would not perhaps perceive from hearing us address some of the more arcane questions.

Mr. Taylor says yes, in the case you pose, that would be held illegal by the rule of reason. Well, sure, it would; it also would be held illegal under the present case law. That is exactly the point. You do not need this legislation. This legislation does not really—I think; it does not, at least, intend to—make legal what should be deemed illegal.

It also, however, is not necessary to change the law to do away with the per se rule to accomplish a result we all think ought to be accomplished.

Mr. Susman says that he is concerned about the fact that you have got situations with buttons and suits and the whole single product problem. I agree that in the case of buttons and suits—we all agree—if you do not have truly two products, then you do not have a tying problem. And this is a question I think that maybe you want to address. I think, as I said in my written statement, the look took a bad turn in trying to define single products, and that is a real problem.

But if you assume that you have truly two separate products with separate product markets, and the per se rule requires you to demonstrate that before you can even have application of it, and the per se rule also requires you to demonstrate economic power so you do not have the problem that Mr. Taylor is worried about—you have plenty of inquiry under the present law into what is reasonable—then you get the right results in these cases, and we all agree on what the right results would be.

Senator LEAHY. Well, in preparing for these hearings, my staff and I looked at a number of economists and legal writers. A number of them argue, I think rather persuasively, that tie-ins involving intellectual properties are procompetitive. Now, let us assume they have a particular bias, let us say a very jaundiced view of it. And let us say if it is not clear that they are clearly anti-competitive—assuming you do not accept totally that they are pro-competitive, but let us say that at least you take a view that they are not clearly anticompetitive—well, then, why shouldn't each tying arrangement be looked at under the rule of reason?

I am just trying to think, if I were in court, trying to determine what type of proof, if I were a defendant, I would try to bring forward, and I would find it awfully, awfully limiting.

Mr. BROWN. The literature to which you are referring, Senator Leahy, started with a great teacher, Aaron Director, at the University of Chicago—he, Professor George Stiegler, a number of other people at the University of Chicago, developed the whole theory, and they centered it on tie-in law to a large extent, demonstrating that the monopolist can only get one monopoly profit. So therefore,

why not allow him to tie, because even if he ties, he is not going to get more than his one monopoly profit.

In effect, that is all a rationalization to say that whatever the market does must be all right. The fact is that that argument does not prove that a tying arrangement is required to accomplish whatever legitimate objective a seller may have; if there is some benefit in putting two separate products—now, we have to assume that—together, there is nothing that prevents a seller from doing that.

The fact is that a seller only adopts a tie if he expects to make sales of the tied product that are not on the merits of the product. He would not do it—he does not need to do it otherwise. And that is what the courts have seen. That is what the Congress addressed in 1914. That is the reason why there is such a powerful truth that they just simply cannot shatter except denying it in the analysis that led Justice Frankfurter to say, many times repeated by other Justices who have thought through the problem, that tying agreements serve hardly any purpose beyond the suppression of competition.

To engage in legitimate licensing activities, you do not need to tie a separate product to it. And when you do, it is the nature of things anticompetitive with respect to that separate product. And I think the whole Chicago school of economists, if you will, cannot demonstrate that they need the tie. And the notion that everything that happens in the market place has to be all right and is defensible is, I think, on the face just simply inconsistent with our whole tradition of the free economy and regulating the free economy by antitrust.

Senator LEAHY. Mr. Susman, would you agree?

Mr. SUSMAN. We agree with a number of things, but that is not one of them. I have received a lot of education since I was on the Hill, Mr. Chairman, the Chicago school of economics is not an area that I identify myself with.

Senator LEAHY. We never identified you with it either when you were up here, Mr. Susman.

Mr. SUSMAN. I think that the view that the seller only ties for anticompetitive blocking motivation is one that, frankly, is equally extreme as the Chicago view that all tying is necessarily good because it only allows a monopolist to reap what is justifiably his.

I think the key is what Mr. Brown may have implied at the end, that if you need to tie, you can demonstrate it, and that is OK. Yet, Mr. Chairman, the *per se* rule will not let you demonstrate that you need to tie, unless you want to rest your entire case on the 1961 and 1962 cases that are cited in Mr. Brown's footnotes.

Mr. BROWN. Excuse me. It does require you to demonstrate economic power, Tom, and that is quite a demonstration to make to begin with.

Mr. SUSMAN. Unless you have a patented or copyrighted product, it requires that demonstration. When you have a product subject to copyright or patent, it presumes your economic power, your market power. But even if you demonstrate economic power, in most cases involving nonintellectual property, in other areas of nonprice restraints, you would have to show some anticompetitive effect. And if you cannot show that, then you would not win.

It seems to me that Mr. Brown is certainly arguing that the results ought to be reasonable in both cases, and I do not think I disagree; I just believe that it is very awkward and misleading to the courts to suggest that you are employing a per se rule, when you are saying, well, it is per se, but you can demonstrate business justification, and you have to show actual market power, and you have to show some displacement or competition. That is no longer a per se rule.

Senator LEAHY. Well, you do not agree with Mr. Brown's suggestion that we address only the presumption of market power—and if I am not restating your position correctly, Mr. Brown—

Mr. BROWN. That is a fair summary of my suggestion.

Mr. SUSMAN. Well, I am certainly delighted to have Mr. Brown's agreement on that part. That only goes part of the way; it is only one side of the problem. Certainly, that would help you with intellectual property licenses. As I point out in my testimony, you also need to deal with the subject of tied products, patented products, so that you do not encourage people only to license patents and not to produce products themselves.

It seems to me you still have the problem with other vertical restraints, restraints other than tying, which at least the Justice Department in some cases has said are subject to a per se rule and in which the presumption of market power has not, as a practical matter, been applied. So that eliminating the presumption would certainly help in your tying cases involving licenses. It would not do a lot for you outside in the nonprice vertical restraint area. And it also would not clearly allow a party to introduce procompetitive motivation or business justification to the extent that you may be troubled, as I am, that that is not as clearly black letter law in tying today; you would need S. 438 and its affirmative statement relating to elimination of the per se rule and enabling defendants to show procompetitive responses in order to complete the package.

In fact, as my testimony indicates, Mr. Chairman, and as I was pleased to hear Mr. Taylor emphasize, we really are talking about three prongs to dealing with the underlying problem of rational treatment of intellectual property; the third prong is patent misuse, which needs reform as well.

Senator LEAHY. Mr. Taylor.

Mr. TAYLOR. About all I can add, Senator, to what has been said on this already is that the principal impact of this bill as I see it is going to occur in the advisory offices of lawyers, where marketing and commercialization decisions get made.

It seems to me that the greatest single handicap presented by the current state of the law is that it restricts perfectly proper, procompetitive arrangements simply because conservative legal advice limits the willingness of clients to start down a road where there is the possibility of an antitrust suit with treble damages, or there is the possibility of having their property rights in technology held unenforceable. When a company has invested millions of dollars in bringing R&D to the point of commercialization, it is an extravagant client that will risk trying to commercialize it when the lawyers recommended otherwise.

The ABA supports S. 438 because it seeks to create a more risk-free environment for commercialization.

Mr. SUSMAN. Mr. Chairman, just before you wrap up the hearings, I have for your record a couple of items. One, I submitted to staff in advance, and it is a legal memorandum addressing specifically the issue of presumption of market power in intellectual property antitrust cases, which I hope will be included in the record.

Senator LEAHY. It will be.

Mr. SUSMAN. Congressman Fish in his statement recited a number of groups supporting this legislation. I will add two others. I am pleased to deliver to the subcommittee for the record a letter from the Computer and Business Equipment Manufacturers Association supporting S. 438. And at our short break this morning, I spoke with Mr. Wamsley of the Intellectual Property Owners Association, who indicated that that group was left off the list, and that he would also be supplying a letter of support to the subcommittees.

[Information follows:]

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CONGRESS SHOULD ELIMINATE THE
PRESUMPTION OF MARKET POWER FOR
PATENTED PRODUCTS AND COPYRIGHTED
WORKS IN ANTITRUST LITIGATION

Legislation to reform the nation's intellectual property laws is currently before Congress. Pending bills, for example, would eliminate the application of the per se rule of antitrust analysis to intellectual property licensing agreements (S. 438; H.R. 557) and reform the law of patent misuse (S. 1200, tit. II; H.R. 1155, § 3105). However, no bill has yet been introduced to undo an erroneous principle plaguing intellectual property owners who find themselves the targets of antitrust allegations in court: the presumption of market power for patented goods and copyrighted works in antitrust litigation.

The presumption by which courts in antitrust cases presume market power for copyrighted works and patented products -- without undertaking actual market analysis -- is a principle of current intellectual property law clearly in need of reform. This presumption has been widely recognized as inaccurate and unjustifiable from an economic perspective. It discriminates against intellectual property rights by treating intellectual property more harshly than other types of property involved in arrangements alleged to violate the antitrust laws. Moreover, recent federal appellate court decisions have confused the law by their disparate application of this presumption.

This memorandum first discusses the development of the presumption and its current application. It then identifies the inaccuracy of the presumption, as analyzed by courts and commentators. Finally, the memorandum argues that legislation is needed to reverse the presumption's distortion of antitrust and intellectual property law and that proposals for reform of this issue should be included in legislation currently under consideration by Congress or otherwise enacted.

Background and Application of the Presumption of Market Power.

Current antitrust law provides that, when a party is charged with "tying," the defendant will be presumed to have market power sufficient for the imposition of antitrust liability if the tying product is patented or copyrighted.

This rule was formulated by the United States Supreme Court in United States v. Loew's Inc., 371 U.S. 38 (1962). In Loew's, distributors of copyrighted motion pictures were charged with violating Section 1 of the Sherman Act, 15 U.S.C. § 1, by their practice of "block-booking" films. The defendants conditioned the sale or license of rights to popular feature films on the purchase or license of additional, unwanted films. This practice was held to constitute tying. The Court cited Northern Pacific R.R. Co. v. United States, 356 U.S. 1, 6 (1958), for the standard of illegality for tying: the seller must have "sufficient economic power with respect to the tying product to appreciably restrain free competition in the market for the tied product." But then the Court held that "the requisite economic power is presumed when the tying product is patented or copyrighted." Loew's, 371 U.S. at 45. The Court cited approvingly the district court's conclusion that "since each defendant by result of its copyright had a 'monopolistic' position as to each tying product, 'sufficient economic power' to impose an appreciable restraint on free competition was present" Id. at 48. The Court continued: "To use the trial court's apt example, forcing a television station which wants 'Gone with the Wind' to take 'Getting Gertie's Garter' as well is taking undue advantage of the fact that to television viewers there is but one 'Gone with the Wind'."

Lower court decisions after Loew's reflect the acceptance and application of the Loew's presumption of market power. In Hazeltine Research v. Zenith Radio Corp., 239 F. Supp. 51 (N.D. Ill. 1965), aff'd, 388 F.2d 25 (7th Cir. 1967), aff'd in part & rev'd in part, 395 U.S. 100 (1969), Zenith alleged that Hazeltine's practice of conditioning license of its patents on the license of additional, unrelated patents violated the antitrust laws. The court based its decision on the coercive power of the patent in forcing the licensee to accept additional unwanted patents. Id. at 76-77. The court undertook no analysis of market power.

In Duplan Corp. v. Deering Milliken, Inc., 444 F. Supp. 648, 673 (D.S.C. 1977), aff'd in part and rev'd in part, 594 F.2d 979 (4th Cir. 1979), cert. denied, 444 U.S. 1015 (1980), the court explicitly cited the Loew's principle that, "When the tying product is patented sufficient market power to enforce a tie-in is presumed. [Citing Loew's.] By

the same token when the patent itself is employed as the tying 'product' the power of the patentee to require a licensee to purchase a different product is unquestioned." The court stated that in its analysis of the defendants' practice of requiring purchasers of machinery to purchase a use license, a practice that allegedly tied nonapplicable patents and unpatented information to other patents, the court "assumed" that the defendants possessed sufficient market power to enforce the alleged tie-ins. *Id.* at 673. (The court eventually concluded, however, that the practice did not constitute an antitrust violation, due to its lack of effect on "a substantial amount of commerce." *Id.*)

The Supreme Court reiterated the Loew's presumption of market power principle in Jefferson Parish Hospital Dist. No. 2 v. Hyde, 466 U.S. 2 (1984). There the Court noted, in dicta, that "if the Government has granted the seller a patent or similar monopoly over a product, it is fair to presume that the inability to buy the product elsewhere gives the seller market power." *Id.* at 16. (This assertion was, however, challenged by Justice O'Connor in a footnote to her concurring opinion, discussed below.)

Soon after the Supreme Court's decision in Hyde, the market power presumption was applied by the Ninth Circuit in Digidyne Corp. v. Data General Corp., 743 F.2d 1336 (9th Cir. 1984), cert. denied, 105 S. Ct. 3534 (1985). In Digidyne the court considered whether Data General's refusal to license certain computer software except to purchasers of its computer hardware was an unlawful tying arrangement under Section 1 of the Sherman Act, 15 U.S.C. § 1, and Section 3 of the Clayton Act, 15 U.S.C. § 14. The court held that it was. In so holding, the Digidyne court relied on the presumption of market power arising from the copyright on the tying product, citing both Loew's and Hyde, 734 F.2d at 1341, 1342, 1344, 1345, although the court did conclude that the presumption was rebuttable and merely shifted the burden of persuasion to the defendant to show that the presumed market power did not exist. The court thus required the defendant to rebut the presumption by showing that its product was not unique, but it then held that evidence of substitutes for the tying product did not show nonuniqueness or rebut the presumption. The court noted that the software involved was "the best in the industry, the most comprehensive, compatible, field proven, and rapid." *Id.* at 1341 n.2. Because copyright law prevented the unauthorized reproduction of the unique software, the court reasoned, the copyright owner had sufficient economic power with respect to the tying product for the practice to violate the antitrust laws. *Id.* at 1342.

Although some courts have treated the presumption as conclusive, see e.g., Duplan v. Deering Milliken, Inc., 444 F. Supp. 648, 873 (D.S.C. 1977), aff'd in part and rev'd in part, 594 F.2d 979 (4th Cir. 1979), cert. denied, 444 U.S. 1015 (1980), recently several courts have concluded, like the Digidyne court, that the presumption of market power is rebuttable. In Susser v. Carvel Corp., 332 F.2d 505, cert. dissm'd., 381 U.S. 125 (1965), where a franchisor required a franchisee to buy or lease patented equipment as a condition to the franchise, the court held that the fact that the equipment was patented would not automatically make the procedure an illegal tying arrangement. The court treated the presumption of market power as rebuttable, holding that the existence of the patent did not require a finding of sufficient market power to constitute a tying arrangement. The court observed, quoting the 1985 Report of the Attorney General's Committee to Study the Antitrust Laws, that

The patent may be broad and basic, in which event the economic power incident to the patent makes the tying clause illegal. On the other hand, the patent may be narrow and unimportant, in which event it may confer virtually no real market power. Accordingly, where the tying product is patented, the patentee should be permitted to show that . . . the patent does not create the market power requisite to illegality of the tying case.

Id. at 521.

In A.I. Root Co. v. Computer/Dynamics, Inc., 806 F.2d 673 (6th Cir. 1986), the Sixth Circuit Court of Appeals limited the Loew's presumption of market power principle by holding that market power may not be presumed from the fact that a computer program that is neither particularly desirable nor unique is protected by copyright. The defendant in A.I. Root was a producer of computer software and hardware. Root, a beekeeping supplies company, brought suit alleging that the defendant's practice of conditioning sale of copyrighted software on the license of certain other software violated the Sherman Act.

The court held that the defendant did not have the requisite economic power for an illegal tie, declaring: "we find the pronouncement in Loew's to be overbroad and inapposite to the instant case. Accordingly, we reject any absolute presumption of market power for copyright or patented product" Id. at 676. The court continued, "More often than not . . . a patent or copyright provides little, if any, market power." Id. (citing Comment, The Presumption of Economic Power for Patented and Copyrighted Products in Tying Arrangements, 85 Colum L. Rev. 1140

(1985)). The court reasoned that because the software concerned was not "particularly unique or desirable," the fact that the software was copyrighted was not determinative of market power. Id. at 677. The court distinguished Digidyne on this basis, pointing out that the tying software in Digidyne was unique.

The district court in 3 P.M., Inc. v. Basic Four Corp., 591 F. Supp. 1350 (E.D. Mich. 1984), also refused to apply a presumption of market power for copyrighted tying products, concluding that Loew's was inapplicable where an absence of market power characterized the software in question.

Erroneousness of the Presumption.

Elementary economic analysis readily reveals the inaccuracy of the presumption that ownership of a patent or copyright conveys market power. See, e.g., R. Posner, Antitrust Law: An Economic Perspective 172 n.3 (1976); Lavey, Patents, Copyrights, and Trademarks as Sources of Market Power in Antitrust Cases, 27 Antitrust L. Bull. 433, 437-39 (1982). Supreme Court Justice O'Connor recognized this in her concurrence in Hyde:

A common misconception has been that a patent or copyright, a high market share, or an unique product that competitors are not able to offer suffice to demonstrate market power. While each of these factors might help to give market power . . . a patent holder has no market power in any relevant sense if there are close substitutes for the patented product.

466 U.S. at 37 n.7.

Mere ownership of a patent or copyright rarely conveys market power because, although the owner may own the exclusive right to produce a product, there may be no demand for that product or there may be substitutable products on the market. Even when there is demand for the product, a patent or copyright grants only limited protection from competition when there are substitutable products on the market. The Supreme Court has recognized in other contexts that "where there are market alternatives that buyers may readily use for their purposes, illegal monopoly does not exist merely because the product said to be monopolized differs from others." United States v. Du Pont & Co., 351 U.S. 377, 394 (1955). See also SCM Corp. v. Xerox Corp., 645 F.2d 1195, 1203 (2d Cir.), cert. den., 455 U.S. 1016 (1981). The ability of the producer or creator of the patented product or copyrighted work to raise prices above a competitive level is limited by the existence of these substitutes. The producer may raise its prices, but so long

as these substitutes exist the producer risks losing market share by doing so. In this situation, the producer's "market power" is severely limited by competitive forces and should not be presumed sufficient to support an antitrust violation.

Commentators have widely rejected the idea that the existence of a patent or copyright gives a product market power. In a panel discussion on "The Value of Patents and Other Legally Protected Commercial Rights," Professor F.M. Scherer, Professor of Economics, Swarthmore College, observed:

A patented product may well be unique. It may, however, face a lot of substitutes, perhaps equally unique; and, as a result of this extensive availability of substitutes, confer very little, if any, monopoly power. Statistical studies suggest that the vast majority of all patents confer very little monopoly power -- at least, they are not very profitable.

53 Antitrust L.J. 535, 547 (1985). See also Comment, The Presumption of Economic Power for Patented and Copyrighted Products in Tying Arrangements, 85 Colum. L. Rev. 1140, 1150 (1985).

Both Scherer and the Columbia Law Review Comment observe, as did Justice O'Connor and the court in A.I. Root, that a patent or copyright confers market power only when there are no substitutes for the copyrighted product. Although each patented or copyrighted product on the market may be different, the differences only confer market power when consumers have a strong preference for a product for which there are no available substitutes. If substitutes exist, the patented product or copyrighted work cannot confer market power because, if the producer attempts to "force" consumers to purchase through tying arrangements or if the producer attempts to set prices above the competitive level, the consumer's preference will shift to another product.

To borrow the example of another commentator:

[A]lthough a patent on a pen design . . . would make the patentee the sole manufacturer of such pens, sales of other pen designs and pencils would constrain the patentee's price. The cost of making the patented pen might even be so high relative to the cost of competing designs that the costs of the patented design would outweigh its benefits. If so, the patent would have no commercial power and would confer no competitive

advantage -- certainly not monopoly power -- on the patentee.

Lavey, supra at 438.

Need for Reform.

Patents and copyrights are a form of property; they are not economic monopolies. As with all forms of property, they may have attributes that make them more desirable to consumers and that, in the absence of available substitutes, may give them significant market power. But that market power should be proved, not presumed. As the Supreme Court stated in Northern Pacific R.R. Co. v. United States, 356 U.S. 1, 10 (1958): "it is common knowledge that a patent does not always confer a monopoly over a particular commodity. Often the patent is limited to a unique form of improvement of the product and the economic power resulting from the patent privileges is slight."

Rejecting the presumption of market power for patented products or copyrighted works would not create an exemption under the antitrust laws applicable to tying arrangements or monopolization claims. To the contrary, the proposed statutory reform would simply put the plaintiff in a tying case involving intellectual property in the same position it would be in in any other tying action: The plaintiff would have to show "sufficient economic power with respect to the tying product to appreciably restrain free competition in the market for the tied product." Northern Pacific R.R. Co., supra at 6.

It is undisputed that, in some circumstances, the uniqueness of a product can result in market power. Yet, as the Supreme Court has stated, in determining whether market power exists, "the proper focus of concern is whether the seller has the power to raise prices, or impose other burdensome terms such as a tie-in, with respect to any appreciable number of buyers within the market." United States Steel Corp. v. Fortner Enterprises, Inc., 394 U.S. 495, 504 (1969) (Fortner I). In United States Steel Corp. v. Fortner Enterprises, Inc., 429 U.S. 610 (1977) (Fortner II), the Court recognized that uniqueness of the tying product may in some situations demonstrate market power, but held that although the credit agreement challenged in the case was unique, that uniqueness did not create an inference of market power. The Court stated: "the question is whether the seller has some advantage not shared by his competitors in the market for the tying product. Without any such advantage differentiating his product from that of his competitors, the seller's product does not have the kind

of uniqueness considered relevant in prior tying-clause cases."

In Acqua Flame, Inc. v. Imperial Fountains, Inc., 463 F. Supp. 736 (N.D. Tex. 1979), the court demonstrated that when uniqueness of a patented product does in fact confer market power, that market power can be identified without relying on a presumption. Acqua Flame involved the sale of a patented device on condition that separate, nonintegral components be purchased as well. While citing Loew's for the principle that forcing a purchaser to purchase nonintegral components along with the purchase of a patented device constitutes an illegal tying agreement, the court did not rely on the presumption of market power in finding the arrangement illegal. The court supported its conclusion with a consideration of the circumstances of sale and the fact that the nonpatented components had been sold at a 30% to 100% markup. Id. at 739.

Without benefit of the presumption of market power, a plaintiff in a tying case where the allegedly tying product is protected by patent or copyright would have to show either that the seller had a dominant position in the market for the tying product, that the tying product has sufficiently unique physical or economic characteristics that confer a special advantage not shared by the seller's competitors, or that a substantial number of customers have accepted the tie-in and there are no explanations other than the seller's market power for their willingness to do so. See 3 P.M., Inc. v. Basic Four Corp., 591 F. Supp. 1350, 1357 (E.D. Mich. 1984); see also American Bar Association Section of Antitrust Law, Antitrust Law Developments (Second) 86-87 (1984). As stated by Justice O'Connor in her concurrence in Hyde, however, the existence of a patent or copyright alone should not suffice to demonstrate market power.

The current presumption of market power for patents and copyrights in antitrust cases does not accurately reflect the actual market power of patented products and copyrighted works. The mere existence of a patent or copyright does not necessarily create market power; a court's assumption that it does distorts antitrust analysis, is economically unsound, and leads to inequitable results. As one commentator has stated, "The correct, unflinching application of economic analysis of market power in antitrust cases is desirable. To obtain this result, the role of intellectual property in the economic determination of market power must be clarified." Lavey, supra at 455. Legislative rejection of the presumption of market power for patented products and copyrighted works is a necessary step toward this goal.

Argument Favoring the Presumption is Meritless

Two possible arguments might be advanced in support of retaining the presumption of market power principle. One of them simply relies on the traditional -- if outmoded -- notion that copyrights and patents constitute statutory monopolies by definition. This notion provided the foundation for the doctrine originally, but appears neither empirically sound nor economically rational in present times.

The other argument advanced by advocates favoring the presumption of market power is that the presumption ordinarily does no harm, since litigation involving allegations of antitrust violations by owners of copyrights and patents arises only where market power does in fact exist. See e.g. Louis Kaplow, Prepared Statement [at 9], Intellectual Property Antitrust Protection Act of 1987, Hearings on H.R. 557, before the Subcomm. on Monopolies & Commercial Law, Comm. on the Judiciary, U.S. House of Reps., April 30, 1987. This argument is without foundation.

First, the value of a patent or copyright to its owner may be significant even in the absence of market power. The financial benefit of a patent or copyright may well be substantial to the owner without the owner's having market power in the sense of being able to coerce customers to purchase tied products or to pay prices free from competitive restraints. A patented product could thus be competing in the marketplace with alternative products at a competitive price and still be sufficiently valuable to the patent to provide incentive for the owner to seek legal enforcement of the patent.

Second, the possibility of treble-damage recovery under the antitrust laws provides some incentive for the bringing of suits even where the market power of a product is minimal or nonexistent for purposes of antitrust analysis. In short, the existence of litigation concerning the patent plainly does not indicate market power.

Compatibility with Licensing Proposal.

Legislative action to reject the presumption of market power for patented and copyrighted goods would be fully consistent with the goals of pending legislation to eliminate the application of the per se rule of antitrust analysis to intellectual property licensing agreements. (S. 438; H.R. 557). This pending legislation would require an actual showing of anticompetitive effect under rule of reason analysis.

The arguments in support of reform of the per se rule, as applied to licensing of intellectual property, argue forcefully in favor of rejection of the presumption of market power as well. The same basic issues underlie both proposals for reform. Both the per se rule and the presumption of market power are judicial short-cuts that prejudice intellectual property rights where prejudice is least appropriate. As intellectual property becomes an increasingly dynamic and substantial element of the United States' economy, our laws must foster, rather than hinder, its development.

Like reform of the per se rule to require application of rule of reason analysis to intellectual property licensing agreements, reform of the presumption of market power rule does not create an exemption from standard antitrust analysis. In both cases legislative reform will result in market analysis of the economic effect of certain practices before these practices can be found to violate the antitrust laws. The requirement that anticompetitive effect be proved rather than presumed is an essential part of creating a judicial environment that will protect intellectual property rights and at the same time guard against abuse of those rights.

Congress Should Effect Resolution of Problem.

Courts have plainly split in three directions on this issue, with some rejecting any presumption, some accepting the presumption but allowing it to be rebutted by a factual showing by the defendant, and some applying the presumption in a per se manner. Unfortunately, the Supreme Court appears to have charted this latter course.

While the courts may well, on their own, eliminate this erroneous presumption of market power in time, it is both more efficient and timely for Congress to act on the matter. Congress is currently considering related issues concerning intellectual property rights and has laid the groundwork for coordinated reform. The escalating importance of intellectual property rights--particularly in technology-related industries--makes it important to achieve needed reforms now to foster further technological growth and encourage investment and expansion of high technology enterprises. Finally, the short life-cycle of many high-technology products requires that reforms be made in a timely and decisive manner. Judicial resolution of these issues would involve long periods of flux and uncertainty in the law, fostering costly litigation. Litigation can be devastating to intellectual property owners, whose products may become obsolete during the course of the litigation. To provide effective protection for high-technology products

that have a market lifespan of months, rather than years, legislative reform is required.

Conclusion.

Congress should enact legislation to clarify and enhance the rights of owners of intellectual property by confirming the principle that the existence of a patent or copyright, in litigation arising under the antitrust laws, should not give rise to a presumption of market power or monopoly power on the part of the owner or licensee of that patent or copyright.

October 16, 1987

CBEMA

The Honorable Patrick J. Leahy
 SR-433 Russell Senate Office Building
 Washington DC 20510

The Honorable Howard M. Metzenbaum
 SR-140 Russell Senate Office Building
 Washington DC 20510

Dear Senators Leahy and Metzenbaum:

On behalf of the Computer and Business Equipment Manufacturers Association (CBEMA), I would like to express support for S. 438, the Intellectual Property Antitrust Protection Act of 1987.

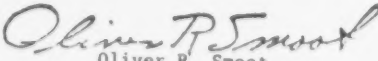
CBEMA endorses S. 438 because it would:

- o allow U.S. companies to receive just rewards from their innovations through more flexible strategies for efficiently marketing and distributing products and services,
- o encourage U.S. companies to make greater investments in innovation which result in new and/or better products and services,
- o foster U.S. economic growth through stimulation of industrial innovation and global competition, and
- o lift unwarranted antitrust threats from innovative U.S. companies thereby permitting them without fear, to rely on intellectual property laws to combat inroads of foreign and domestic piracy.

CBEMA represents the leading edge of American high technology companies in computers, business equipment and telecommunications. Its 38 members had combined sales of more than \$145 billion in 1985, representing 3.7% of our nation's gross national product. They employ more than 1.2 million people in the United States.

Our member companies are becoming increasingly aware of the importance of intellectual property rights for our industry and for the future growth of U.S. economy. This bill will encourage innovation through the clarification of intellectual property rights within the established framework of intellectual property and antitrust law. We commend you and support you in your efforts towards passage of this legislation.

Sincerely,


 Oliver R. Smoot
 Acting President

IPO

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Falls Church, VA

November 18, 1987

The Honorable Patrick J. Leahy
Chairman
Judiciary Subcommittee on
Technology and the Law
United States Senate
Washington, DC 20510

Dear Senator Leahy:

I am writing on behalf of Intellectual Property Owners, Inc. (IPO) in support of S. 438, your bill on intellectual property licensing and antitrust law.

IPO is an association of corporations, small businesses, universities and individuals who own patents, trademarks and copyrights. Our members are responsible for a significant portion of the research conducted in the United States and they have extensive experience with technology licensing.

We strongly endorse enactment of S. 438, because we believe it will encourage licensing and strengthen incentives for American firms to create and commercialize new technology. The legislation will help restore America's competitiveness.

IPO testified before a Senate Judiciary Subcommittee in favor of similar legislation in 1984 (Title III of S. 1841, 98th Congress). The need for the legislation is as great now as it was then.

Intellectual property licensing is pro-competitive. Licensing makes available to competitors the right to use intellectual property which otherwise would be unavailable to them. Licensing causes products to be made available to a broader range of consumers and in a greater variety than otherwise would be the case.

We favor both of the substantive sections of the bill: Section 2, which prohibits judging licenses under a "per se" rule, and Section 3, which eliminates trebling of damages in cases involving licensing practices.

It makes no sense to condemn pro-competitive licensing practices under a "per se" standard of illegality. Trebling of

A NONPROFIT ASSOCIATION REPRESENTING PATENT, TRADEMARK AND COPYRIGHT OWNERS

INTELLECTUAL PROPERTY OWNERS, INC.

The Honorable Patrick J. Leahy
Page 2

damages also is inappropriate for licensing cases. The incentive of treble damages is not needed to encourage detection of unlawful licensing practices. Licensees have incentives without treble damage recovery to challenge any practice that improperly restricts their ability to compete.

Witnesses at the hearing last month pointed to various court decisions which illustrate the need for the legislation. Although the amount of antitrust litigation concerning licensing practices has been relatively small recently, the perception continues to exist in the business world that the antitrust laws make it risky to engage in certain types of licensing. We believe this perception causes owners of intellectual property to be unnecessarily reluctant to license.

Enactment of S. 438 would do a great deal to put to rest the idea that intellectual property law and antitrust law are in conflict. Passage of the legislation would increase confidence in the business community that courts would view the two bodies of law as having complementary objectives. The national economy would benefit from the resulting encouragement that would be given to licensing.

We note one technical problem with the language of S. 438. The term "invention" as defined in lines 13 and 14 of page 3 of the bill does not appear to be broad enough to cover plant patents and design patents, which are governed by Chapters 15 and 16 of Title 35 of the United States Code. We would be glad to provide suggestions on how to redraft the bill on this point.

I hope the Subcommittee finds these views helpful. We request that this letter be made a part of the record of the hearing held on October 20, 1987.

Sincerely,

Donald W. Banner

Donald W. Banner
President

DWB/vp

Senator LEAHY. Thank you. I have a number of questions, too, which I am going to submit in writing, as other Senators will. Some people wanted to testify who were unable to make it today, and their statements will be included in the record, as will other Senators' statements.

In fact, I am going to keep the record for this joint hearing open for a month for the inclusion of further materials. I believe Senator Hatch has an opening statement, and I know Senator Thurmond did, and without objection, his will be inserted immediately after my opening statement at the beginning of the hearing.

The vote now is a cloture vote on whether we should go forward with debate on invoking the War Powers Act. Some other realities intrude on the Senate as we go along.

I must compliment the three members of this panel especially. If we did not have the vote coming up, I would love—and you might not enjoy this—but I would love to stay here and listen to the three of you, back and forth on this issue. This is a major education for me, and I think it will be for others who have to work on this.

Mr. BROWN. Let me say, Senator, that I have enjoyed the dialog tremendously with you, but it is a privilege for me also to be on the panel with two friends who are among the true leading practitioners in the field. I have enjoyed the privilege of being with them as well as appearing before your committee.

Senator LEAHY. I am glad to hear that. You know, there are hearings going on all over the Hill, all day long, and we see the well-televisioned ones—those are the confirmation hearings of Judge Bork; the Iran hearings, and others—and you get to see those, but that is such a tiny fraction of what goes on.

I have had friends who have come down and visited and who have just gone around the halls and found out how fascinating some of the hearings can be and how intellectually riveting they can be.

I appreciate again all three of you being here. This is a very complicated area, and you know that far better than anybody else here. What we do has, I think, enormous ramifications.

[Questions and answers of panel, subsequently received for the record, follow:]

Answers from Jack E. Brown to Senator Leahy's Questions:

Question 1:

Current per se rules may subject even companies with small market shares to costly antitrust litigation. For example, companies bringing suit to collect amounts due from purchasers of equipment, or to protect copyrights from infringers, might be subjected to antitrust counterclaims. Are you aware of such cases?

Answer:

I am aware of antitrust counterclaims asserted by defendants in copyright infringement suits and collection suits and that, in some of those cases, the plaintiffs can be described as having "small market shares" (although that sometimes is subject to question since market definition is more of an art than a science and a tricky exercise at best). I have represented plaintiffs in such cases. See, e.g., Apple Computer Inc. v. Franklin Computer Corp., 714 F.2d 1240 (3d Cir. 1983), cert. dismissed, 464 U.S. 1033 (1984) (antitrust counterclaim cannot avert preliminary injunction in copyright infringement suit).

Whatever generalizations are drawn from such cases,* the statement that "[c]urrent per se rules may subject even companies with small market shares to costly antitrust litigation" is not a valid complaint:

The per se rules have been employed primarily in price-fixing and closely-related cases. No one (at least until now) has even suggested that a low market share should be considered a good defense in such cases.

* No doubt some antitrust suits are unwarranted but I suspect that there are many more valid antitrust claims that are never brought than there are invalid claims that are brought. As for the expense of defending antitrust suits, the increasing availability of summary judgment and other defense motions has done much to mitigate that specter. The recent Supreme Court decision in Matsushita Electric Industrial Co. v. Zenith Radio Corp., 475 U.S. 574 (1986), already has been effectively employed to dismiss difficult to prove antitrust complaints.

Answer to Question 1 Continued:

As for the utilization of a kind of per se rule in tying cases, proof of market power in such cases has been authoritatively and definitively held to be a prerequisite of illegality. Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2 (1984).*

Thus, if some companies with only a small degree of market power have been subjected to some unjustified antitrust claim, it cannot be because of the per se rules.

* Market power is a broader and more significant concept than market share. The Herfindahl-Hirschmann Index, adopted in the Department of Justice Antitrust Division's 1984 Merger Guidelines and 1985 Vertical Restraints Guidelines, provides examples of companies with "small market shares" that nevertheless might have significant market power. Also, market power--defined as the power to raise prices significantly without loss of sales--can be demonstrated by direct proof. Where such proof is available, it is unnecessary to go through the exercise of market definition and measuring market share in order to infer market power. See R. Schmalensee, Another Look at Market Power, 95 Harv. L. Rev. 1789, 1798-99 (1982).

Question 2:

We have heard testimony criticizing the rule by which many courts in antitrust cases presume market power from the existence of a patent or a copyright. Do courts presume market power in antitrust cases other than in the intellectual property context?

Answer:

Courts may "presume" market power from proof of different facts, or congeries of facts, in every type of context, not just in cases involving patent, copyright or trade secret licenses or other cases involving intellectual property in some way. Cf. The Mozart Co. v. Mercedes-Benz of North America, Inc., Nos. 86-1733 and 86-2156, slip. op. at 14 n.5 (9th Cir. Dec. 9, 1987): "per se rules are simply examples of presumptions that exist throughout antitrust law."

The Department of Justice, for example, has issued Guidelines creating presumptions of market power in merger cases from the existence of a Herfindahl-Hirschmann Index of 1800. Dep't of Justice Antitrust Division Merger Guidelines, p. 20 (1984). Some courts have created a presumption of market power based on a showing that a defendant had, at a given time, 70% of the current sales of some product line in some market, and contrariwise presumed a lack of market power where market share was asserted to be less than 50%.

Reference to a patent as an indicator of market power is in itself based on a presumption that a patent indicates uniqueness--i.e., when the government has granted the seller "a patent or similar monopoly over a product, it is fair to presume that the inability to buy the product elsewhere gives the seller market power." Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 466 U.S. 2, 16 (1984). That quality of uniqueness can be shown in other ways in different contexts with a like presumption of market power if it is also shown that the uniqueness cannot be easily defeated, i.e., when "the seller offers a unique product that competitors are unable to offer." Id. For an instructive recent explanation, see The Mozart Co. v. Mercedes-Benz of North America, Inc., Nos. 86-1733 and 86-2156, slip. op. at 9-10 (9th Cir. Dec. 9, 1987).

The significant fact is that the so-called presumption of market power from the existence of a patent or copyright has been and is a factor of slight consequence in any antitrust case. In the real world it takes a lot more to prove market power.

Question 3:

As the presumption is presently applied by the courts, does a determination of the amount of economic power conferred by a patent or copyright require analyzing substitutes for the product and the relevant market?

Answer:

Yes, if the owner of the patent raises such questions.*

Question 4:

Section 3 of S. 438 eliminates treble damage recoveries in antitrust actions involving agreements to convey intellectual property rights. Should it set out qualifications or limitations before its detrebling provisions apply? If so, what kind of qualifications would be appropriate?

Answer:

If treble damages are eliminated, I would hope that it would not be on a wholesale basis. At the very least, a court (or a jury) ought to have discretion to award treble damages taking into account the nature of the conduct found to be unlawful, the extent of the injury to competition proven and the wilfulness of defendant's violation of the applicable law.

Question 5:

Are the antitrust rules that apply in cases challenging intellectual property agreements an area where federal law should preempt state law?

* A determination of market power does not necessarily require analyzing substitutes for a product and a relevant market in any type of case (whether or not a patent or copyright is involved). Market power--defined as the power to raise prices significantly without loss of sales--can be demonstrated by direct proof. Where such proof is available, it is unnecessary to go through the exercise of market definition and measuring market share in order to infer market power. See R. Schmalensee, Another Look at Market Power, 95 Harv. L. Rev. 1789, 1798-99 (1982).

Answer:

Yes. See *Motorola, Inc. v. Fairchild Camera & Instrument Corp.*, 366 F. Supp. 1173, 1185, n.3 (D. Ariz. 1973) ("while state law governs this area generally, conflicts with the federal law of antitrust and patents must be resolved in favor of the latter"); *CVD, Inc. v. Raytheon Co.*, 769 F.2d 842, 855 (1st Cir. 1985), cert. denied, 106 S. Ct. 1198 (1986) ("the federal interest in the 'full and free use of ideas in the public domain' will override state law in conflict with it").

Question 6:—

If federal law should preempt state law in this area, does the bill need to do so expressly, or is silence sufficient to accomplish preemption?

Answer:

Whether or not a particular state law will be preempted by the proposed legislation depends on the extent to which that particular state law is viewed as inconsistent with the proposed legislation. If the conflict is apparent, no more should be required. See the cases cited in response to Question 5.

Question 7:

Should the bill apply to intellectual property owners who manufacture their own products as well as to those who license their products? Why or why not?

Answer:

I don't understand the proposed distinction. Intellectual property owners who manufacture their own products may, or may not, license their products. The same is true of others who do not manufacture their own products.

If the question posed is whether a manufacturer should be given the same antitrust immunities as would be accorded to a developer who merely licenses others to use his invention or work product, I don't see a valid basis for distinguishing between them. However, it should be understood that, unlike what developers who are primarily licensors may desire, what manufacturers may seek is a privilege not to license their products.

Answers from Jack E. Brown to Senator DeConcini's Questions:

Question 1:

In your statement you say that S. 438 makes no distinction between or among different kinds of cases. You point out specifically that S. 438 could be used to protect cartels from per se review. The ABA Antitrust Division argues in favor of the legislation and says that S. 438 would not undermine enforcement policies in cartel situations.

Are you aware of the ABA Antitrust Division's views on this issue?

As a cosponsor of the legislation, I can tell you we do not intend to immunize cartels. I believe with the Division and your help we can clarify and remedy this disagreement. Would you support the rule of reason provision if clearly anti-competitive arrangements such as cartels were not affected?

Answer:

I am aware of Robert Taylor's testimony, but I don't understand how the ABA Antitrust Section (or anyone else) can argue with a straight face that S.438 would not undermine enforcement of the antitrust rules against price-fixing or other cartel arrangements among competitors; without some amendment, that result seems to me ordained.

If S.438 is amended to eliminate that effect, that would leave it to apply only in tying cases. My view is that true tying arrangements oftentimes are pernicious and should be viewed as presumptively illegal (certainly, as at present, where the seller is proven to have market power in the tying product). I realize that the Chicago school of economists has persuaded many members of the antitrust bar to believe that, contrary to the premise of the Clayton Act, tying arrangements are often pro-competitive. However, I think the arguments to that effect are entirely theoretical and there has never been a demonstration that tying arrangements in practice are ordinarily required or useful for any purpose other than to stultify the development of competition in the tied product. Moreover, where a defendant does have some business justification for tying two products, as in franchise or other cases where a tie-in is required to assure quality control, that is now permitted to serve as an absolute defense. See the recent decision in The Mozart Co. v. Mercedes-Benz of North America, Inc., Nos. 86-1733 and 86-2156, slip. op. at 14-20 (9th Cir. Dec. 9, 1987) (upholding a business justification defense and explaining "We have recognized that antitrust defendants may demonstrate a business justification for an otherwise per se illegal tying arrangement").

Consequently, I would not support the proposed law even if it were amended to apply only to licenses effectuating tie-ins. I also would oppose the law because it would eliminate the

treble damage remedy in some cases, and provide a precedent for doing so in other cases, which I would consider a mistake.

However, I would not oppose a law such as I have drafted (attached as Exhibit A) which would address the "single product" problem to make it clear that the proscription of tie-ins is addressed only to the tying of true separate products. I also would not oppose a law to the effect that the grant of a patent or copyright in itself should not give rise to a presumption of market power.

[JEB Draft No. 1--11/4/87]

PROPOSED "SINGLE PRODUCT" LEGISLATION

S. _____

1. For purposes of this Enactment:

(a) The term "product" shall have the same meaning as "goods, wares, merchandise, machinery, supplies, or other commodities" in Section 3 of the Clayton Act.

(b) The term "antitrust laws" shall mean Sections 1 and 2 of the Sherman Act, Section 3 of the Clayton Act and Section 5 of the Federal Trade Commission Act.

2. A lease or sale or contract for sale of two products shall not be deemed a tie-in lease or sale or contract for sale of those products for purposes of the anti-trust laws if (i) the products do not have any utility or function except when used in conjunction with each other and are not ordinarily sold or leased separately but instead are ordinarily sold as components of a unit; or (ii) one of the products is a credit or other financial term of the lease or sale or contract for sale which a competitor could readily offer if it chose to do so.

Question 2:

You argue in your statement that S. 438 is unnecessary because the case in which you participated, Digidyne Corp v. Data General Corp., is not the last judicial word on the subject and that courts will satisfactorily resolve that problem. Wouldn't it be a bit more efficient if Congress were to step in and speak on the subject rather than let courts differ for several years and the Supreme Court finally have to decide? Isn't it the proper role of Congress to set antitrust policy?

Answer:

I agree that Congress should set antitrust policy. However, for Congress to act simply to reverse a small dictum in one pronouncement of one court of appeals decision is not a good way to correct the dictum, assuming it needs correction. The danger is, as illustrated in S.438, that the legislation will be drafted by those who have a lot more than that in mind (and who, indeed, want to undo declared Congressional policies) and will approach the subject with a meat ax rather than a scalpel. As noted above, even though I don't think one is needed, I would not oppose a pinpointed correction.

Question 3:

As I understand your testimony, you conjecture that the per se rule in tying cases may be abandoned in the near future. You cite the opinions of Burger, O'Connor, Powell and Rehnquist in Jefferson Parish and white and Blackmun in Data General for that proposition.

If this is true, wouldn't it be better policy for Congress to determine the appropriate standard for tying cases than to let the shifting majorities of the Supreme Court determine it?

Answer:

Yes, an overall appropriate standard for tying cases is the kind of antitrust policy which Congress should enact. I don't view S.438 as doing that. What it would do is effectively negate any enforcement of or reliance on section 3 of the Clayton Act and thus undermine a declared Congressional policy of many years' standing. If that is what a majority of the Congress wants to accomplish (which I doubt), then I agree it should so declare.

As you correctly state, I think the Supreme Court already is headed in that direction but at least there is hope that a future Supreme Court, with a greater understanding of the underlying economic problem, will be more faithful to the spirit of the Clayton Act in considering future tying cases.

Answers from Jack E. Brown to Senator Thurmond's Questions:

Question 1:

You argue that the per se rule should not be eliminated with respect to any practices affecting intellectual property. What is the practical difference in outcome between applying the rule of reason standard, which would allow a full look at the competitive environment, and applying the per se standard, which would permit no such inquiry?

Answer:

There is today not a great deal of practical difference between requiring rule of reason proof and employing a per se rule in any type of case. Both the litigants and courts almost always look at the competitive environment and, in result, even some price-fixing arrangements are not held to be illegal. See, e.g., *Broadcast Music, Inc. v. Columbia Broadcasting Sys.*, 441 U.S. 1 (1979). As recently noted by Judge Sneed, "Before applying the per se label one must determine whether the challenged practice is one of those types that 'is plainly anticompetitive' and very likely 'without redeeming virtue.'" *The Mozart Co. v. Mercedes-Benz of North America, Inc.*, Nos. 86-1733 and 86-2156, slip. op. at 14 n.5 (9th Cir. Dec. 9, 1987). There is very little practical difference especially in tying cases since, under the present rules, the plaintiff is explicitly required to prove market power at least in the tying product and the defendant is allowed to plead a business justification for the tying arrangement if he can do so.

However, the so-called "rule of reason" has been employed in an unreasonable way in some cases to require vast amounts of proof in wide-ranging economic inquiries. Surely there is no reason to require such inquiries in price-fixing and tying cases.

Question 2:

You appear to argue primarily that enacting S. 438 would make it more difficult to bring antitrust cases against licensing agreements, and therefore less likely that such cases will be brought. Is it not true, however, that most antitrust cases outside the intellectual property area are rule of reason and that this standard has not inhibited individuals from bringing litigation? Why should it be any different for intellectual property cases?

Answer:

It is true that the per se rule today is applied only to price-fixing and output restrictions (and perhaps some boycotts) and, in a qualified limited way, to tying arrange-

ments. Thus, many antitrust cases are decided without the benefit of any per se rule as such and the government or a private antitrust plaintiff is required to proceed with a rule of reason inquiry.

It is not true, however, that antitrust cases have not been inhibited by the myriad of rules that have been developed under the guise of required proof under a "rule of reason"--particularly the requirement of a vast and expensive economic inquiry into market definition and measurement.

Basically, I agree with the premise that there is no occasion for different antitrust rules in cases involving intellectual property and in other cases. The fact that a patent or copyright might be involved (or dragged in, if not primarily involved) seems to me to offer no justification for changing the rules as they are applied today in all price-fixing, output restriction and tying cases.

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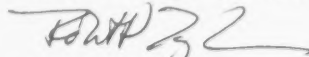
February 11, 1988

Sen. Patrick J. Leahy
United States Senate
Committee on the Judiciary
Washington, D.C. 20510-6275

Dear Senator Leahy:

Attached are my responses to the questions posed in your letter dated January 7, 1988 with respect to S.438. This is a follow-up to testimony which I gave October 20, 1987, on behalf of the American Bar Association, before a joint hearing of the Subcommittees on Technology and the Law and Antitrust, Monopolies and Business Rights. Although the statements set forth herein are my own and not necessarily those of the ABA, they are consistent with the 1984 ABA report on which my testimony was based.

Respectfully submitted,


Robert P. Taylor

Encs.

cc: James F. Rill, Esq.
Chairman, ABA Section on
Antitrust Law

Mr. E. Bruce Nicholson
ABA Government Affairs
Group
ABA Washington Office

RPT14/K

QUESTIONS FROM SENATOR LEAHY

1. Are the courts looking to Congress to make a decision on the continued application of the per se rule to tie-ins involving intellectual property?

If we are to achieve the creation of a legal environment which truly encourages the transfer and licensing of technology, I think that statutory action will be required. The nature of the judicial process and the speed with which that process can change its course are such that meaningful reform is unlikely to come from the courts, at least in any reasonable time frame. As recently as four years ago, for example, the Supreme Court demonstrated the intransigence of the judiciary in this area. In Jefferson Parish Hospital Dist. No. 2 v. Hyde (1984) 466 U.S. 2, a majority of the Court voted to continue using per se rules to analyze tying cases, even though recognizing that in reality the analysis is closer to a rule of reason approach. Inexplicably, the Court went out of its way, by way of dicta, to say that market power should be "presumed" where the tying product is covered by a patent or copyright (466 U.S. at 16-17).

A recent decision of the Court of Appeals for the Federal Circuit specifically called upon Congress, in the context of applying the misuse doctrine, to reconsider the appropriateness of per se rules in light of modern economic learning. In Senza-Gel Corp. v. Seiffhart (Fed.Cir. 1986) 803 F.2d 661, 665, the Federal Circuit held:

"We are bound * * * to adhere to existing Supreme Court guidance in the area until otherwise directed by Congress or by the Supreme Court".

Taken together, the Jefferson Parish and Senza-Gel decisions present a compelling argument that the law is not likely to be rationalized anytime soon without intervention by the Congress.

2. Current per se rules may subject even companies with small market shares to costly antitrust litigation. For example, companies bringing suit to collect amounts due from purchasers of equipment, or to protect copyrights from infringers, might be subjected to antitrust counterclaims. Are you aware of such cases?

I have seen numerous instances where infringement litigation has prompted a companion antitrust counterclaim, not so much as an effort to rid the market of a trade restraint but purely as a defensive tactic to fend off the infringement suit. In virtually every suit brought to enforce patent rights, it is standard practice for the defendant to scrutinize the marketing and licensing practices of the plaintiff in search of a possible misuse defense and/or antitrust counterclaim. These counterclaims and defenses can take many forms, the most common being claims of unlawful tying and fraud in the procurement of the patent. As to the latter, the Federal Circuit, in Kimberly-Clark Corp. v. Johnson & Johnson (Fed.Cir. 1984) 745 F.2d 1437, 1454, recently complained that "[f]raud in the [Patent Office] has been overplayed, is appearing in nearly every patent suit, and is cluttering up the patent system."

3. What practical problems does the per se rule present for you? For example, what evidence will the court consider in a tying case involving intellectual property, and what evidence will it refuse to consider?

The problem with per se rules generally is that the courts focus only on the form of a particular arrangement and find illegality without regard to the commercial considerations which motivated it or the market effects which the arrangement brings about. The decision in Arizona v. Maricopa County Medical Society (1982) 457 U.S. 332 is a good example. There a large number of the physicians in Maricopa County, as part of a community wide

medical insurance plan created as an alternative to more traditional forms of medical insurance, agreed to charge no more than a scheduled fee in dealing with insureds of the particular plan. In a suit brought by the Arizona Attorney General, the Supreme Court affirmed a summary judgment for the plaintiff and struck down the arrangement as per se unlawful. The stated basis for the ruling was that of judicial convenience. In spite of arguments by the defendant that the arrangement was socially beneficial and procompetitive, the Supreme Court refused to sanction the use of judicial time even to hear and analyze the business reasons for and the market effects of any agreement which circumscribed the freedom of parties to set their own prices. The Court said:

"The elaborate inquiry into the reasonableness of a challenged business practice entails significant costs. Litigation of the effect or purpose of a practice often is extensive and complex. * * * Judges often lack the expert understanding of industrial market structures and behavior to determine with any confidence a practice's effect on competition. * * * And the result of the process in any given case may provide little certainty or guidance about the legality of a practice in another context. * * *

"The costs of judging business practices under the rule of reason, however, have been reduced by the recognition of per se rules. Once experienced with a particular kind of restraint enables the Court to predict with confidence that the rule of reason will condemn it, it has applied a conclusive presumption that the restraint is unreasonable. As in every rule of general application, the match between the presumed and the actual is imperfect. For the sake of business certainty and litigation efficiency, we have tolerated the invalidation of some agreements that a fullblown inquiry might have proved to be reasonable" (457 U.S. at 343).

Even if one fully accepts the rationale for using per se rules in certain cases such as price fixing and bid-rigging, that use should be confined to those arrangements which demonstrably have a "pernicious effect on competition and lack * * * any redeeming virtue" (Northern Pac. Ry. Co. v. United States (1958) 356 U.S. 1, 5). Stated

differently, the courts should avoid the use of per se rules, as a policy matter, whenever there is any likelihood that the particular business form under scrutiny will be procompetitive and beneficial. The Supreme Court, in Broadcast Music, Inc. v. CBS (1979) 441 U.S. 1, 19-20, noted this as follows:

"[In deciding whether to use a per se rule], our inquiry must focus on whether the effect and, here because it tends to show effect, the purpose of the practice [is] to threaten the proper operation of our predominantly free-market economy--that is, whether the practice facially appears to be one that would always or almost always tend to restrict competition and decrease output, * * * [or] one designed to 'increase economic efficiency and render markets more, rather than less, competitive.'"

4. Since the late 1970s, the Justice Department has abandoned the policy statement known as the "Nine No-Nos"--licensing practices the Department considered presumptively illegal. Any future administration could resurrect that policy. Would S. 438 give companies investing in R&D more certainty as to what rules will govern the future?

During the 1960s and 1970s, the Department of Justice was extremely hostile toward almost all licensing arrangements wherein the licensee was required to refrain from using the licensed technology to compete with the licensor or other licensees of the licensor. The rationale for this policy, sometimes referred to as the "Nine No-Nos," was that while the patent grant gave to the patent owner a right to license, any restrictions on the license were to be tested under the Sherman Act. Further, the Department of Justice urged the application of per se rules to restrictive licensing practices on the theory that most or all licensing of technology occurred between competitors or potential competitors. The policy ignored the fact that in many instances any licensing, even on a restricted basis, would be socially beneficial and therefore more desirable than no licensing at all.

Even though the views of the Department of Justice are not necessarily the law, the policy inhibited licensing in two ways. First, no company wants the cost and risk of being sued by the Department of Justice for violation of Section 1 of the Sherman Act. Not only are the litigation costs themselves prohibitive, but the potential private liability that could result from a government victory is a further and powerful deterrent. Second, many courts are deferential to the views of the Department of Justice regarding the outer limits of antitrust policy, so that in practice the government's view often becomes the law. In connection with patent-antitrust policy, this deference was reinforced by the widespread use of consent decrees barring particular licensing practices.

In my experience, the policies of the Department of Justice created considerable resistance by owners of technology to grant licenses. It often happens, for example, that a manufacturer in one area of commerce may be willing to license new technology for use in other areas, but only with assurances that the licensee will not use the technology in direct competition with the licensor. Similarly, a small company with limited resource facilities may be justifiably reluctant to license a larger more technologically capable competitor without assurances of access to any improvement technology developed by the licensee, i.e., grant back provisions. As the government viewed things in the 1970s, both of these restrictions would have been per se illegal.

Even though the current Department of Justice has retreated from the excesses of earlier years, the enactment of S. 438 is still needed, because it will decrease the danger that some future Administration will return to formerly held views with respect to restrictive licensing. With the foregoing history as a backdrop, this is important

commercially, because most licenses last the entire duration of the patent, i.e. up to seventeen years.

5. We have heard testimony criticizing the rule by which many courts in antitrust cases presume market power from the existence of a patent or a copyright. Do courts presume market power in antitrust cases other than in the intellectual property context?

Courts often presume market power in cases brought under Section 2 of the Sherman Act. In a monopolization case, for example, the plaintiff is required to show monopoly power, i.e., the power to raise prices without losing market share. In United States v. Grinnell Corp. (1966) 384 U.S. 563, 571, the Supreme Court said that "[monopoly] power ordinarily may be inferred from the predominant share of the market."

A better case can be made for using high market share as a surrogate for market power than for presuming market power merely because of the existence of intellectual property. Pricing and output decisions by a seller with 80% or 90% of a market are able to have at least a short term effect on the market, whereas such decisions by a patent or copyright holder may be without even a short-term effect. Justice O'Connor, in her concurring opinion in Jefferson Parish Hospital Dist. No. 2 v. Hyde (1984) 466 U.S. 2, 37-38 n. 7, calls attention to the obvious but often ignored commercial reality--a patented or copyrighted product may have numerous substitutes and be in vigorous competition with all sorts of products not covered within its ambit.

6. As the presumption is presently applied by the courts, does a determination of the amount of economic power conferred by a patent or copyright require analyzing substitutes for the product and the relevant market?

It is not completely clear to what extent the presumption of economic power conferred by a patent or copyright is rebuttable or conclusive, although most of the

recent cases seem to permit the owner of the patent of copyright to put in evidence showing that there are substitutes and that the patent or copyright does not confer actual market power. A recent decision of the Sixth Circuit, for example, refused to find market power for copyrighted software in the face of close substitutes (A.I. Root Co. v. Computer Dynamics, Inc. (6 Cir. 1986) 1986-2 Trade Cases (CCH) ¶ 67,363). The court distinguished the ruling of the Ninth Circuit in Digidyne Corp. v. Data General Corp. (9 Cir. 1984) 734 F.2d 1336 saying that market power should be presumed only when the product is truly unique. Even in Digidyne, the finding of market power was based upon a determination by the jury after a lengthy trial on that issue.

There are, however, some older cases that have never been overruled and that appear create a conclusive presumption of market power. In International Salt Co. v. United States (1947) 332 U.S. 392, the government sued the owner of a patent on salt processing machines claiming that per se illegality resulted from a requirement that users of the machines purchase salt from the patent owner. In affirming summary judgment for the government, the Supreme Court stated: "it is unreasonable, per se, to foreclose competitors from any substantial market" (332 U.S. at 396). The International Salt decision was cited with approval by the majority opinion in Jefferson Parish Hospital Dist. No. 2 v. Hyde (1984) 466 U.S. 2, 16 ("Thus, the sale or lease of a patented item on condition that the buyer make all his purchases of a separate tied product from the patentee is unlawful"). In disagreeing with the majority on this point, Justice O'Connor suggested that the decision in International Salt was wrongly reasoned because it confused tying as an antitrust concept with tying as a patent misuse concept (466 U.S. at 37-38 n. 7).

7. In your discussion with Senator Specter, you observed that when compared to the rest of the antitrust cases it decides, the Supreme Court reviews a minuscule number of antitrust cases involving intellectual property rights. Please explain the significance of this phenomenon.

There is a history of some 60 or 70 years wherein the Supreme Court exhibited increasing hostility to the very concept of intellectual property. Much of that hostility was based upon a real or perceived application of antitrust principles to the commercialization of new ideas and new technology. Although the pendulum presently is moving the other direction, there remain on the books literally dozens of Supreme Court decisions from that earlier era and dozens more in the lower courts which applied antitrust concepts to specific types of transactions. Those decisions operate as a deterrent to licensing, because lawyers feel compelled to advise clients that particular practices--which might be optimal from a commercial point of view--were once held illegal and therefore present significant risks if raised in a litigation context. Even though older precedent may be philosophically at odds with emerging precedent, few companies are enthusiastic about placing their technology at risk to become test cases.

A classic illustration of this problem can be seen in the Supreme Court decision in Dawson Chemical Co. v. Rohm & Haas Co. (1980) 448 U.S. 176 wherein the Court construed sections 271(c) and 271(d) of the Patent Act to permit the licensing of a process patent on terms which required the licensee to purchase from the patent owner an unpatented chemical needed to practice the process.* The

* Those two sections were incorporated into the Patent Act in 1952 in a Congressional effort to override some of the far reaching implications of the 1946 decision of the Supreme Court in Mercoird Corp. v. Mid-Continent Co. (1944) 320 U.S. 661.

Davison decision, although attended by a genuine concern that a patent owner be allowed sufficient latitude to profitably commercialize his new technology, is necessarily narrow and appears to be limited to those situations where the unpatented chemical has no non-infringing uses, a statutory requirement of section 271(c).

In contrast to Dawson is a Ninth Circuit decision, Rex Chainbelt Inc. v. Harco Products Inc. (9 Cir. 1975) 512 F.2d 993, 1002, wherein that court held that it was patent misuse to sell unpatented epoxy resins for use in a patented process without offering a separate license on the process alone. It is not at all apparent from Dawson that the Rex Chainbelt case would come out any differently today, unless the epoxy were to have no non-infringing uses. Indeed, the Court of Appeals for the Federal Circuit recently cited Rex Chainbelt with approval and found misuse where the patent owner failed to establish that a machine sold to practice a patented process was without non-infringing uses (Senza-Gel Corp. v. Seiffhart (Fed.Cir. 1986) 803 F.2d 661, 667-69). Thus, for all of its helpful philosophy, Dawson gives little comfort to a licensor in a similar situation.* There are countless examples of the same phenomenon.

8. In your discussion with Senator Specter, you noted the relatively minuscule number of antitrust cases involving intellectual property rights that the Supreme Court decides as a reason why antitrust rulings involving intellectual property are more restrictive than other antitrust decisions. Are there other reasons?

My specific reference was to the tendency of

* Even if the patent owner believes that the unpatented product is without noninfringing use, this is not a fact he can control nor is it one where his knowledge is complete. Thus, the patent owner who opts for a licensing scheme of the type used in Dawson and Rex Chainbelt still runs the risk of per se illegality, because an important operative fact may have to await trial.

courts to presume market power from the existence of a patent or a copyright. I discussed this in response to Questions 1, 5 and 6 above, and can add nothing more.

9. In his written testimony, Mr. Brown stated that extending the bill's protections to trade secrets would create considerable opportunities for antitrust abuse because of the breadth and ambiguity of the information that trade secrets protect. Should S. 438 apply to trade secrets? Why or why not?

I see no compelling reason to apply S. 438 to trade secrets. Few courts have treated trade secrets with the same general hostility that has been shown patents and copyrights, and the antitrust jurisprudence in this area has not developed so as to generally inhibit licensing. Not only are trade secret licenses usually analyzed under a rule of reason, there is little danger of having a trade secret invalidated through misuse concepts. On the other side of the ledger, however, there is no apparent reason to apply per se rules to a trade secret license, and I would certainly not object to including trade secrets within the ambit of S. 438. Indeed, since many licenses in the real world cover both trade secrets and patents, it is logical to apply S. 438 across the board.

10. Should the bill apply to intellectual property owners who manufacture their own products as well as to those who license their products? Why or why not?

In my view, S. 438 should apply to all licensing of intellectual property, whether or not the licensor is also in the manufacturing business. The commercial considerations that arise in connection with the decision to license are sufficiently varied and complex that the use of per se rules is almost always inappropriate.

QUESTIONS FROM SENATOR THURMOND

1. Much of the discussion concerning the elimination of the per se rule for intellectual property has focused on tying arrangements. Are there anticompetitive practices involving intellectual property with which we should be concerned? For example, in his prepared comments, Mr. Brown cites agreements to fix prices, restrict output and divide markets.

Obviously, we should be concerned with all anticompetitive practices, whether or not they involve intellectual property. The issue with respect to S. 438 is not whether or not there should be a concern with anticompetitive practices, but whether we should test bona fide commercial licenses under a per se rule as opposed to a rule of reason analysis. The point of my testimony and that of the ABA report is that very few of these transactions can properly be analyzed under per se rules.

The application of the rule of reason to licensing is not likely to legitimize wrongful behavior or to burden the courts inordinately in trying to analyze such behavior. The Supreme Court made clear in F.T.C. v. Indiana Federation of Dentists (1986) 106 S.Ct. 2009, 2018 that where a particular arrangement has anticompetitive purposes or effects, no extensive amount of testimony or evidence is needed in order for the court to find it unlawful under a rule of reason analysis:

"Application of the Rule of Reason to these facts is not a matter of any great difficulty. * * * While [a refusal by the respondent dentists to provide patient x-rays to insurance carriers] is not price-fixing as such, no elaborate industry analysis is required to demonstrate the anticompetitive character of such agreement'" (106 S.Ct. at 2018).

The rule of reason approach merely permits the parties to a particular transaction to come forth with evidence as to why and with what effect they have done what they have.

2. Should we be concerned about "sham" licensing agreements, that is, licensing agreements whose primary purpose is to facilitate collusive conduct or other anticompetitive activity?

I do not believe that S. 438 will encourage sham licensing arrangements, i.e., situations where collusive anticompetitive conduct is designed to masquerade as a patent or copyright license. The courts have considerable experience in separating legitimate licenses from sham licenses. In United States v. Gypsum Co. (1948) 333 U.S. 364, for example, the Supreme Court held that price restrictive patent licenses on an improved form of gypsum constituted an unlawful cartel. The Court refused to accept the argument made by the defendants that the arrangement was nothing more than a license agreement permitted by the General Electric doctrine.* Similarly, in Timken Co. v. United States (1951) 341 U.S. 593, 598-599, the Supreme Court held there to be no exemption from the antitrust laws for a trademark license whose purpose was to divide world markets:

"Appellant's premise that the trade restraints are only incidental to the trademark contracts is refuted by the District Court's finding that the 'trade mark provisions * * * were subsidiary and secondary to the central purpose of allocating trade territories.' Furthermore, while a trademark merely affords protection to a name, the agreements in the present case went far beyond protection of the name 'Timken' and provided for control of the manufacture and sale of antifriction bearings whether carrying the mark or not."

* In United States v. General Electric (1926) 272 U.S. 476, the Supreme Court held that a patent owner does not violate the antitrust laws by imposing upon his licensee a requirement that the licensee not underprice the licensor in connection with the sale of items covered by the patent.

RESPONSES OF THOMAS M. SUSMAN
TO QUESTIONS SUBMITTED BY CHAIRMAN LEAHY

1. Q: Are the courts looking to Congress to make a decision on the continued application of the per se rule to tie-ins involving intellectual property?

A: Justice Brennan, concurring in Jefferson Parish Hospital v. Hyde, 466 U.S. 2, 32 (1984), cited one reason for continuing to adhere to the traditionally held conclusion "that tying arrangements are subject to evaluation for per se illegality under §1 of the Sherman Act":

"Whatever merit the policy arguments against this longstanding construction of the Act might have, Congress, presumably aware of our decisions, has never changed the rule by amending the Act."

The closely split Court and the lack of clear guidance provided in the Jefferson Parish decision has left lower courts without a rational, workable standard for tying cases. Congressional guidance is clearly appropriate.

Moreover, recent cases have recognized the weak foundation that underlies current application of the per se rule, as well as the presumption that the existence of a patent or copyright conveys market power. See, e.g., A.I. Root Co. v. Computer/Dynamics, Inc., 806 F.2d 673 (6th Cir. 1986); 3 P.M., Inc. v. Basic Four Corp., 591 F. Supp. 1350 (E.D. Mich. 1984). Courts in these cases appear to be searching for an alternative to traditional per se analysis of tying arrangements

involving intellectual property. The Supreme Court has not provided such an alternative. Therefore, it is especially appropriate for Congress to act in this area.

Although the Supreme Court in Jefferson Parish referred in dicta to application of the per se rule with respect to intellectual property rights, (466 U.S. at 16), the holding in Hyde did not directly address application of the per se rule to intellectual property rights. However, when the Supreme Court denied certiorari in Data General Corp. v. Digidyne Corp., 105 S.Ct. 3534, 3535 (1984), Justice White noted in his dissent from the denial that "this case raises several substantial questions of antitrust law and policy, including . . . what effect should be given to the existence of a copyright or other legal monopoly in determining market power."

2. Q: Current per se rules may subject even companies with small market shares to costly antitrust litigation. For example, companies bringing suit to collect profits due from purchasers of equipment, or to protect copyrights from infringers, might be subjected to antitrust counterclaims. Are you aware of such cases?
- A: Small companies may indeed be subjected to costly and protracted litigation because of the current antitrust law bias against intellectual property. The current rule that the economic power necessary to sustain a tying charge will be presumed when the tying product is patented or copyrighted leads to the result that the marketing practices of a small company with negligible market power can be held to be per se unlawful, despite the lack of any showing

of actual economic power with respect to the tying product.

In Aqua Flame, Inc. v. Imperial Fountains, Inc., 463 F. Supp. 736 (1979), for example, the licensor of a patented device sued a licensee for royalty payments. The licensee counterclaimed that, among other things, the licensor's practice of selling the device together with certain unpatented components was a tying arrangement and per se illegal under the antitrust laws. The court based its finding of the economic power requisite for establishing an illegal tying arrangement on the existence of the patent, stating that "the Plaintiff used its monopoly power derived from the patent" to force the defendant to buy the unpatented components, and held the marketing practice per se illegal. *Id.* at 739.

A.I. Root Co. v. Computer/Dynamics, Inc., 806 F.2d 673 (6th Cir. 1986), also demonstrates how a company with a mere two to four percent share of the relevant market could be presumed to have market power requisite for per se liability under standard antitrust analysis. There, Management Assistance, Inc. ("MAI"), a computer company, was charged with violating the antitrust laws in connection with licensing its software. Under standard antitrust doctrine, because the alleged tying product (software) was copyrighted, economic power requisite for a tie would have been presumed from the copyright. Under this approach MAI could have been found to have violated the antitrust laws without any actual showing of economic power.

In fact, the court in Root rejected the presumption of market power, citing law review commentary and Justice O'Connor's concurrence in Jefferson Parish. Yet the facts of the case indicate how the prevailing doctrine, which eliminates the requirement that the plaintiff in an antitrust case show actual economic power, encourages litigation against small companies with negligible market shares and subjects such companies to costly antitrust litigation and potential liability for activity never shown to be anticompetitive.

3. Q: We have heard testimony criticizing the rule by which many courts in antitrust cases presume market power from the existence of a patent or a copyright. Do courts presume market power in antitrust cases other than in the intellectual property context?

A: No. The existence of a patent or copyright on an alleged tying product is the only factor from which courts presume market power.

Courts do occasionally use shortcuts in reaching the conclusion that a party has market power. For example, the Supreme Court in Northern Pacific Ry. Co. v. United States, 356 U.S. 1, 7 (1958), observed that "the defendant possessed substantial economic power by virtue of its extensive landholdings."

In Jefferson Parish Justice O'Connor stated that the existence of a unique product has been perceived as demonstrating market power. 466 U.S. 16, 37 n.7. But even this implicates intellectual property rights and creates a bias against them in antitrust cases, since uniqueness is essential for patent protection and usually a characteristic of copyrighted works.

4. Q: As the presumption is presently applied by the courts, does a determination of the amount of economic power conferred by a patent or copyright require analyzing substitutes for the product and the relevant market?

A: No. The presumption of market power bypasses actual analysis of the relevant market, including consideration of the availability of substitutes for the product. Without the presumption of market power, a charge of tying must be supported by a showing of actual market power, including consideration of the demand for and the existence of substitutes for the tying product.

As Justice O'Connor stated in Jefferson Parish, "a patent holder has no market power in any relevant sense if there are close substitutes for the patented product." 466 U.S. at 37 n.7. However, the presumption of market power as it is ordinarily applied by the courts involves no such analysis of substitutes.

5. Q: Some have argued that eliminating the presumption of market power in antitrust cases involving patents or copyrights would amount to making the current per se rule for tie-ins a de facto rule of reason. Do you agree?

A: No. Eliminating the presumption of market power would merely provide that intellectual property owners will not be worse off than others when charged with tying in antitrust litigation. If only the presumption were eliminated (and the per se rule remained), then intellectual property owners could still be subject to per se liability, but only where market power, in the broad sense of the term, had been proven.

The requisites of a per se illegal tie-in are: (i) a tying arrangement must exist in fact between two distinct products or services; (ii) the defendant must have sufficient economic power in the tying product market to appreciably restrain competition in the tied product market; and (iii) the amount of commerce affected must be "not insubstantial." Fortner Enterprises v. U.S. Steel, 394 U.S. 495, 499 (1969). The presumption of market power in cases involving a patented or copyrighted product effectively relieves the plaintiff of the requirement of proving the defendant's economic power in the tying product market. If the presumption of market power were eliminated, all three elements of the charge would have to be proven. If they were proven, then the tying arrangement would be per se illegal.

In contrast to the three-pronged analysis of alleged tying arrangements, which may result in per se illegality, rule of reason analysis involves detailed market analysis of the actual anticompetitive effect in the market for the tied product as part of a general determination whether a particular practice constitutes an unreasonable restraint of trade. Such analysis involves findings with respect to market definition, market power, and general adverse effects on competition, among other factors. See generally, FTC v. Indiana Federation of Dentists, 476 U.S. 447 (1986).

6. Q: Mr. Brown linked the increasing foreign ownership of U.S. patents to his view that S. 438 would weaken rather than strengthen America's competitiveness. Do you agree with Mr. Brown?

A: No. The increasing number of foreign patentees is an indication of the increasingly international arena in which protection of intellectual property rights is sought. Filings of U.S. patents by foreigners have increased, as have filings in foreign patent offices by United States entities. Testimony presented by Professor Richard Levin before the Judiciary Committee in 1987 indicated that the United States "exported" nearly three times the number of patent applications than it "imported." No other country, including Japan and West Germany, came close. Professor Levin concluded: "In fact, the United States has not yet surrendered its leading position in high technology." Prepared testimony of Richard C. Levin at hearing on "Competitiveness and Antitrust," before the Committee on the Judiciary, U.S. Senate (May 7, 1987).

In addition, the simple comparison of numbers of filings does not take into account the relative quality of the innovations involved. U.S. companies are recognized as international leaders in the development of significant technological breakthroughs. Although entities from other countries may file large numbers of "spin-off" patents, the United States still dominates the international scene in terms of technological innovativeness.

Finally, the need to protect intellectual property rights is not simply based upon the desire of the owners of intellectual property to protect their rights. The primary purpose of intellectual property protection is to encourage innovation and

the development of new products that benefit the consumer and improve the standard of living of society at large. Innovations, whether foreign or U.S. generated, have this positive effect. By filing for patent protection, patent owners gain a limited period of protection in exchange for disclosure of the patent. Protection of patent rights is an important part of encouraging the public disclosure of valuable innovations through the patent system. This is true whether the patents are of foreign or of U.S. origin.

7. Q: In his testimony, Mr. Brown stated that extending the bill's protection to trade secrets would create considerable opportunities for antitrust abuse because of the breadth and ambiguity of the information that trade secrets protect. Should S. 438 apply to trade secrets? Why or why not?

A: Trade secrets -- which state laws define (with some variation from state to state) as confidential, non-public knowledge relating to and useful in the conduct of a particular trade or business -- are, like other forms of intellectual property, protected by special laws due to their intangible nature.¹ Like innovations protected by patent and copyright laws, the innovations protected by trade secret law must be recognized as property and protected as such to encourage future innovation and to encourage distribution of such property by the owner.

¹ With respect to the definition of trade secrets, see 1 R. Milgrim, Trade Secrets §2.01 (1987) (compilation of definitions of a trade secret); M. Jager, 1984 Trade Secrets Handbook §3.04 (1984) (Uniform Trade Secrets Act definition of a trade secret: "information ... that (i) derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use, and (ii) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy").

The reasoning that supports rule of reason rather than per se analysis of tying arrangements involving patents or copyrights also supports the rule of reason analysis of tying arrangements involving trade secrets. Per se analysis discourages the licensing of property rights that, like trade secrets, are difficult to protect. The owner of a trade secret is less likely to extend the benefit of its trade knowledge through licensing if, in addition to the danger of unauthorized disclosure that is raised by licensing trade secrets, the licensor faces potential per se liability. Actual analysis of market conditions under the rule of reason will insure that beneficial practices that extend trade knowledge and that are not anticompetitive will not subject the owner of trade secrets to antitrust liability.

8. Q: Are the antitrust rules that apply in cases challenging intellectual property agreements an area where federal law should preempt state law?

A: The federal antitrust rules that apply in cases challenging intellectual property agreements should preempt state antitrust rules, such as the law of unfair competition, insofar as federal and state rules conflict. However, state antitrust rules should remain viable law to the extent that there is no conflict.

9. Q: If federal law should preempt state law in this area, does the bill need to do so expressly, or is silence sufficient to accomplish preemption?

A: Like The National Cooperative Research Act of 1984, 15 U.S.C.A. §4301-4305, which applied the rule of reason to joint research and development ventures,

S. 438 should provide for the application of rule of reason analysis to licensing and other marketing arrangements involving intellectual property "in any action under the antitrust laws or under any State law similar to the antitrust laws."

10. Q: Should the bill apply to intellectual property owners who manufacture their own products as well as to those who license their products? Why or why not?

A: S.438 should apply in both cases. The same antitrust concerns exist whether intellectual property owners manufacture patented or copyrighted products and sell those products, or license their patents or copyrights to other manufacturers. In both cases, the antitrust laws said here should not discourage or prohibit conduct which transfers intellectual property rights through transactions that are mutually beneficial to transferee and transferor and which do not have an anticompetitive effect.

11. Q: You suggested in your written testimony that Section 2 of the bill should be amended to read "agreements or refusals to convey" rights in intellectual property rights. Please explain how such agreements are treated under current law and why you have recommended such an amendment.

A: Current law provides that owners of intellectual property rights have the right to refuse to convey such property. However, refusals to license intellectual property rights except under certain conditions have been argued to constitute unlawful tying arrangements subject to per se analysis. Action which is otherwise lawful should not be illegal under the antitrust laws unless it in fact has an anticompetitive effect.

RESPONSES OF THOMAS M. SUSMAN
TO QUESTIONS SUBMITTED BY SENATOR THURMOND

1. Q: Much of the discussion concerning the elimination of the per se rule for intellectual property has focused on tying arrangements. Are there anticompetitive practices involving intellectual property with which we should be concerned? For example, in his prepared comments, Mr. Brown cites agreements to fix prices, restrict out-put, and divide markets.

A: There are anticompetitive practices involving intellectual property that should remain subject to per se analysis. For example, agreements to fix prices, currently subject to per se analysis, should and would continue to be subject to per se analysis if S. 438 were enacted. Per se analysis is intended to be applicable only to those activities inevitably or necessarily anticompetitive. Because tying activities involving intellectual property are not necessarily or inevitably anticompetitive, these activities should not be subject to per se analysis.

2. Q: Should we be concerned about "sham" licensing agreements, that is, licensing agreements whose primary purpose is to facilitate collusive conduct or other anticompetitive activity?

A: The application of the rule of reason to arrangements involving intellectual property does not create an incentive for "sham" licensing agreements so long as legislative application of the rule of reason is limited to tying arrangements and does not apply to pricing or horizontal activities. A "sham" patent license might be used to disguise, for example, horizontal price fixing, but S.438 would clearly not apply -- and should not apply -- to these agreements.

RESPONSES OF THOMAS M. SUSMAN
TO QUESTIONS SUBMITTED BY SENATOR DeCONCINI

1. Q: Probably the most useful part of S. 438 is the provision related to tying arrangements. Why should intellectual property tying arrangements differ from other cases?

A: The per se rule is intended to apply only where conduct is inevitably anticompetitive. Intellectual property tying arrangements are not inevitably anticompetitive and therefore should not be subject to the per se rule. In fact, intellectual property licensing is often procompetitive and economically efficient.

It may well be that the rule of reason should be applied to all tying arrangements; legal scholars, economists, and a minority of Supreme Court justices have eloquently argued for this proposition. But, for now, national policies favoring innovation and advancement of technology argue strongly for statutory application of the rule of reason at least where tying of intellectual property is implicated.

It is particularly undesirable to apply the per se rule to intellectual property tying arrangements because under current law the presumption of market power combines with per se analysis so that a party may be found liable under the antitrust laws without any showing of economic power or anticompetitive effect. Antitrust liability for tying arrangements involving other types of property is not imposed without actual proof of economic power in the relevant market.

2. Q: How is the consumer benefited by this provision of S. 438? Why wouldn't he be better off being able to buy the tied product on an open market? Why should Congress legislate a preference for such tying arrangements rather than letting the marketplace decide how such products should be sold?

A: The consumer benefits from both intellectual property protection and antitrust enforcement -- through encouraging and protecting innovation and development of new products and more efficient processes, and through ensuring that such products can find their way into a competitive marketplace. S. 438 creates no antitrust exemption for intellectual property!

The provisions of S. 438 related to tying arrangements benefit the consumer by allowing free market activity with respect to the exchange of intellectual property rights so long as such activity does not have an anticompetitive effect. S. 438 recognizes that the consumer is benefited by the active distribution of technological innovations.

Senator LEAHY. I am very, very concerned with what we do in this area and how we will continue to be competitive and how we will exert the kind of leadership that we need as a country. I am 47 years old, and I have seen remarkable changes from the time I was in high school. I have seen far more than the years would indicate. And I do not think any one of us could sit in this room and predict with total accuracy what we are going to see at the beginning of the next century, especially in the high-tech field—and yet that is only 13 years away. But I want us to have the chance to be the nation which is competitive in that.

With that, we will stand in recess. Thank you.

[Whereupon, at 11:45 a.m., the joint subcommittee hearing was closed.]

APPENDIX

ADDITIONAL SUBMISSIONS FOR THE RECORD

STATEMENT

OF

CHARLES F. RULE
ASSISTANT ATTORNEY GENERAL
ANTITRUST DIVISION

SUBMITTED TO THE

SUBCOMMITTEE ON TECHNOLOGY AND THE LAW
AND
SUBCOMMITTEE ON ANTITRUST, MONOPOLIES,
AND BUSINESS RIGHTS
COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

CONCERNING

S. 438
INTELLECTUAL PROPERTY LICENSING LEGISLATION

ON

OCTOBER 20, 1987

The Department of Justice appreciates the opportunity to submit its views to the Subcommittees on S. 438, which is designed to encourage the development of new technologies by ensuring that procompetitive licensing of technologies is not unreasonably discouraged. This legislation is very important. If adopted, it should significantly benefit our economy.

I very much regret that a prior commitment outside of Washington has prevented me from personally testifying on behalf of S. 438. I very much would like to add my voice to the bipartisan chorus of support for this extremely important bill.

Over the last 6 years there has been an increased awareness of the importance to our economy of innovation and the development of new technologies. Indeed, new technologies help address some of the most important economic issues of our day--productivity, inflation, unemployment and our international balance of trade. Advances in technology bring dramatic increases in productivity that permit products to be made at a fraction of their old cost. With lower costs comes also a tempering of inflation. Indeed, even during the 1970s, high technology industries such as electronics bucked the trend of runaway inflation by providing equivalent products at ever-decreasing costs. With respect to unemployment, new

technology has resulted in the creation and growth of new industries that were not previously envisioned. For example, millions of people are currently employed in computer-related fields that were not even in existence 20 years ago. With respect to our balance of trade, which is of such significant concern today, the development of new technologies can have a dramatic effect in improving the ability of U.S. firms to compete in foreign markets.

Indeed, the ability of our industry consistently to produce major innovations is a major advantage that the U.S. has in the international marketplace. The combination of a tremendously creative citizenry with a free-market economic system that encourages those citizens to devote their resources to innovation has produced an economy with an unsurpassed ability to discover and develop new technologies.

During the past 6 years this Administration and the Congress have been very active in crafting new legislation to increase the level of intellectual property protection available to innovators. By making such protection available, we encourage increased investment in R&D and hence increased innovation.

In our free-market, profit-oriented economy, the amount a firm will invest in developing new technologies typically will depend upon the perceived financial rewards from its investment--the higher the perceived rewards, the greater the R&D investment. The anticipated rewards from any particular R&D investment can diminish significantly, however, if once the new technology is brought into the marketplace, others are free to use it in competition with the creator. If potential creators of new technologies expect substantial diversion of profits due to uncompensated use of the technology by others, the expected economic reward of R&D investments will be lessened, the incentive to make such investments will be reduced, fewer technological breakthroughs by American firms will occur, American competitiveness will suffer, and consumers will face fewer choices and higher prices. Intellectual property protection addresses this problem by restricting the unauthorized use of a new technology developed by others. It thereby promotes innovation and results in consumers and firms having access to inventions and technologies that otherwise would not have been discovered.

The modification of the scope of intellectual property protection that has occurred in recent years does not eliminate all existing counterproductive disincentives to invest in innovation. In addition to assuring that the scope of

available intellectual property protection is adequate to promote innovation, it also is crucial that the law encourage the efficient use of the intellectual property that has been created. This is an area that is ripe for legislative improvement and that is appropriately addressed by S. 438 and other pending bills.

One of the key methods of encouraging the efficient use of intellectual property is through licensing arrangements. Licensing has the potential for significant procompetitive benefits. The creator of a new technology often will not be in the best position to commercialize the technology to the maximum extent desirable in all possible fields. For example, others may have superior manufacturing or distribution capabilities. This is particularly likely to occur in instances where the creator of the new technology is a small firm or an individual.

Licensing permits the owner of the technology in effect to convey part of his proprietary right in the technology for fair value, thus combining his assets with the manufacturing or distribution assets of others and encouraging the development and utilization of the technology in the most efficient way possible. When licensing leads to more efficient use of technology, it improves the competitiveness of American firms

and benefits consumers. Because the possessor of exclusive rights in intellectual property has no obligation to share his property, any licensing increases the number of people with access to the property. By permitting the owner of a patent or other intellectual property to realize efficiencies, licensing increases the perceived value of the patent and thereby increases the incentive to invest in the procompetitive development of new technologies.

Because of the importance of intellectual property licensing to competition and competitiveness, it is crucial that our laws not unnecessarily discourage such licensing. Towards this end, bills seeking to foster procompetitive licensing arrangements have been introduced with strong bipartisan support in both the Senate and the House. S. 438, introduced by Chairman Leahy, with Senators Hatch, Thurmond and Humphrey as co-sponsors, and H.R. 557, introduced by Congressman Fish, with Congressmen Frank, Moorhead, Synar, Lungren, Hyde and Dannemeyer as co-sponsors, both improve legal treatment of intellectual property licensing by assuring that licensing arrangements receive full and proper consideration under the antitrust laws. The Administration has submitted a very similar proposal to clarify the antitrust treatment of licensing arrangements and related proposals that similarly would ensure that other bodies of law do not deter or inhibit

procompetitive licensing arrangements. These Administration proposals are part of S. 635, introduced by Senator Thurmond with Senator Cochran as co-sponsor, and are also part of the Administration's overall trade and competitiveness package, S. 539, introduced by Minority Leader Dole with Senators Simpson and Cochran as co-sponsors.

Licensing and the Antitrust Laws

S. 438 and the similar proposals I have mentioned are intended to reassure American firms that the licensing of intellectual property will not receive hasty and harsh treatment under the antitrust laws. Through the years, there unfortunately has been a widespread and incorrect perception that intellectual property protection is inherently inimical to antitrust competition policy. This misperception is derived from two sources. First, there is extensive dicta in certain court opinions suggesting this conflict. ^{1/} Second, during the 1970s, officials in the Department of Justice gave a series of speeches that warned that certain types of intellectual

^{1/} For example, the Supreme Court has called patents "monopolies" that should be limited. See, e.g., United States v. Line Material Co., 333 U.S. 287 (1948).

property licenses would be viewed with considerable hostility under the antitrust laws. 2/

For the reasons I have explained previously, however, we have come to recognize that the intellectual property laws and the antitrust laws do not conflict. In fact, they are complementary. When properly interpreted, both promote competition, thereby benefiting consumers and the competitiveness of American firms. 3/

2/ See, e.g., Remarks by Deputy Assistant Attorney General Bruce Wilson, "Department of Justice Luncheon Speech Law on Licensing Practices: Myth or Reality?" (January 21, 1975). Practitioners outside the Justice Department have continued to suggest a conflict between the antitrust and patent laws. Only a few years ago, the Antitrust Section of the ABA held a National Institute on patent licensing, at which one of the authors began with the bald assertion that "[t]he antitrust and patent laws conflict at their interface." Sobel, *The Antitrust Interface with Patents and Innovation: Acquisition of Patents, Improvement Patents and Grant-Backs, Non-Use, Fraud on the Patent Office, Development of New Products and Joint Research*, 53 *Antitrust L.J.* 681 (1985).

3/ See, e.g., Remarks by Charles F. Rule before the Legal Conference sponsored by the World Trade Association and the Cincinnati Patent Law Association, "The Antitrust Implications of International Licensing: After the Nine No-no's" (Oct. 21, 1986); Remarks by Roger B. Andewelt before the Houston Patent Law Association, "Basic Principles to Apply at the Patent-Antitrust Interface" (Dec. 3, 1981); Remarks by Abbott B. Lipsky before the American Bar Association Antitrust Section, "Current Antitrust Division Views on Patent Licensing Practices" (Nov. 5-6, 1981).

Types of intellectual property, such as patents, really are not monopolies; they simply create property rights. 4/ Property rights, in turn, are the cornerstone of an efficient free-market economy. They create the incentive for private investment in productive activity by providing the investor with the means to appropriate the returns from his efforts free from undue interference by third parties.

The rights conveyed by a patent grant are really no different from the rights of the owner of a tangible asset, such as a factory. The owner of each has the right to exclude others from using it without his or her consent. It is relatively easy to prevent the unauthorized use of tangible property. It is not as easy to control a piece of technology embodied by a patent because it is intangible--it is information. A patent, in effect, converts the information into property like the factory--the patent grant provides a government-enforced recognition that once the patentee has publicly disclosed the information, it has a right to exclusive use of the patented technology.

4/ Some court decisions have recognized this basic point. See, e.g., *Schenck v. Norton Corp.*, 713 F.2d 782, 786 n.3 (Fed. Cir. 1983). As recently as 1984, however, the Supreme Court in dictum referred to "the patent monopoly" and "the market power it confers," see *Jefferson Parish Hospital District No. 2 v. Hyde*, 466 U.S. 2, 16 (1984). Four Justices in concurring in the Court's decision described the notion that a patent necessarily conveys market power as "a common misconception." *Id.* at 37 n. 7 (O'Connor, J., concurring).

Unfortunately, there clearly exists the perception in the business community that the antitrust laws are hostile to certain forms of licensing arrangements, and this perception appears to be deterring procompetitive licensing arrangements. This is not surprising. Antitrust suits are expensive to litigate, very expensive to lose and thus are to be avoided.

Faced with a similar perception concerning the antitrust status of research and development joint ventures, Congress in 1984 passed the National Cooperative Research Act (NCRA). ^{5/} Based on the recognition that joint R&D ventures are generally procompetitive and fully consistent with the antitrust laws, that legislation sought to encourage such ventures. It did so by providing that such ventures would not be deemed illegal per se under the antitrust laws but instead would be evaluated under the antitrust rule of reason, and that in certain circumstances any antitrust recovery against a joint R&D venture that proved anticompetitive would be limited to single damages rather than the customary treble damages. ^{6/} Among the activities included within joint R&D ventures eligible for such rule of reason evaluation and single damages is "the granting

^{5/} Pub. L. No. 98-462, 98 Stat. 1815 (codified at 15 U.S.C. §§ 4301-4305).

^{6/} 15 U.S.C. § 4303.

of licenses for results of such venture." 7/ The NCRA thus was intended to reassure firms that joint R&D ventures will not be hastily condemned under the antitrust laws. We believe the NCRA has been successful with respect to joint R&D. 8/

S. 438 takes an approach that is similar to the approach taken in the NCRA with respect to joint R&D ventures. S. 438 (as well as H.R. 557 and S. 635) would ensure that licensing arrangements covering a variety of types of intellectual property will not be evaluated under the per se doctrine, but instead will be evaluated under the antitrust rule of reason. Such a rule of reason analysis would permit the licensee to explain to the court any procompetitive benefits that result from the challenged activity. This bill thereby will help ensure that courts will consider the business justifications and procompetitive aspects of all suspect licensing arrangements in antitrust cases. It will also guarantee that only arrangements that are proven to be anticompetitive will be held unlawful. Significantly, this legislation would not

7/ See 15 U.S.C. § 4301(a)(6).

8/ To date, there have been written notifications filed pertaining to 90 joint research and development ventures under the NCRA. Pursuant to the requirements of 15 U.S.C. § 4305(a), there have been 74 additional disclosure notifications filed, pertaining to matters such as changes in a venture's membership.

render lawful any anticompetitive licensing scheme. Rather it would merely assure that courts hear all relevant evidence on the probable economic effects of a challenged practice. Anticompetitive licenses would remain illegal.

S. 438 (as well as H.R. 557 and S. 635) also recognizes that the trebling of damages generally provided under the antitrust laws may well be overdetering procompetitive licensing arrangements that allow American firms to realize fully their investments in innovative R&D. Accordingly, this legislation also provides for single damage recovery in antitrust cases based on intellectual property licensing arrangements instead of treble damages. Here, too, S. 438 follows the approach of the NCRA in seeking to avoid deterring procompetitive activity.

Preemption of Inconsistent State Antitrust Laws

We have been asked to address the question of preempting state antitrust laws that are inconsistent with the requirement in S. 438 that the courts use a rule of reason analysis or the requirement that the courts "détreble" antitrust damages in cases based on intellectual property licensing arrangements.

Once it has been determined that the object of a bill is a proper subject for federal action under the Commerce Clause or

some other grant of authority to Congress under Article I of the Constitution, the question whether to include a state law preemption provision in the bill often arises. The question is normally a difficult one because it involves a weighing of fundamental federalism concerns against concerns that inconsistent state laws not be allowed to disrupt a national policy reflected in the legislation. In light of the principles of federalism which underlie our constitutional structure, the presumption must be against preemption. Advocates of preemption must meet a heavy burden to overcome that presumption. ^{9/}

We also believe that in instances where Congress decides that preemption is warranted, that decision should be articulated as clearly as possible. Congress has expressly and clearly opted for preemption in both the Export Trading Company Act of 1982 ^{10/} and the NCRA. ^{11/} If Congress determines that in this instance state laws pose a threat to the goals of

^{9/} The Administration's 1983 proposal to provide rule of reason treatment and make detrebling available for research and development joint ventures--a proposal that culminated in the enactment of the NCRA--did not contain state law preemption provisions. Congress apparently determined in that instance that state laws did in fact pose a threat to the goals of the NCRA sufficient to warrant preemption.

^{10/} 15 U.S.C. § 4021.

^{11/} 15 U.S.C. §§ 4302, 4303(c). See also n.9, supra.

S. 438 sufficient to warrant preemption, the preemption should be as explicit and clear as in those two statements. We believe that both the presumption there should be against preemption and the demonstrated ability of Congress to achieve preemption explicitly in antitrust legislation strongly suggest that if this legislation is silent on preemption, there will be no preemption.

Conclusion

A healthy R&D environment is crucial to the continued success of our economy. Enactment of the NCRA went part of the way toward improving that environment, but at least equally important is enacting new statutes that encourage procompetitive licensing of intellectual property. We encourage prompt attention to the pending legislation.

STATEMENT OF DIANNE M. NAST
TO THE COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

RE: S.438

I am a director and shareholder of the firm of Kohn, Savett, Klein & Graf, P.C., 2400 One Reading Center, 1101 Market Street, Philadelphia, Pennsylvania. I have an extensive antitrust practice, representing both plaintiffs and defendants.

I have also served a three year term as co-chairman of the American Bar Association Litigation Section's Antitrust Committee, and am currently a member of the Litigation Section's Council. This statement is presented to summarize the views of individual members of the Antitrust Committee of the Litigation Section with respect to S.438, and is not an official statement of any American Bar Association Committee or entity.

Committee members were surveyed to ascertain their views with respect to S.438 and a review of their opinions reveals that support of S.438 is virtually non-existent on the committee.

I will provide a brief summary of the many comments offered by committee members who reviewed the proposed legislation.

While the committee members of the ABA Antitrust Committee are aligned with the ABA Antitrust Section as strong supporters of licensing new technology because of its "extremely beneficial" nature to society as a whole, and

while it further agrees with the Antitrust Section on the unnecessary "chilling effect" caused by meritless litigation, many individuals on the Committee believe that abandoning the per se rules of illegality with regard to provisions in intellectual property licenses is unwise.

Section 2 of S.438 would eliminate the application of per se rules of antitrust illegality to licenses of patents, trade secrets and copyrights. The Antitrust committee opposes such a provision.

First, per se rules are presently utilized primarily in price-fixing and tie-in cases - practices which are usually both anti-competitive and economically unjustified. In tie-in cases, the per se rule is not normally relied upon unless substantial "market power" is demonstrated. Although a presumption of such market power may, in some cases, be drawn from the existence of a patent or copyright or trade secret, other proof of economic leverage must underlie any such presumption. Notwithstanding the Ninth Circuit's opinion in Digidyne Corp. v. Data General Corp. 734 F.2d 1336 (9th Cir. 1984), cert. denied, 473 U.S. 908 (1985), where very persuasive economic proof of the defendant's market power dwarfed copyright and trade secret issues and where unique liability circumstances existed, restrictive legislation is not needed at this time.

Second, applying a "rule of reason" analysis to all intellectual property license cases would have the practical effect of legalizing the price-fixing and tying practices which might be reached, albeit infrequently, by employing per se rules. Furthermore, application of the "rule of reason" would require plaintiffs to prove market power and injury to competition on a scale required by the

courts in monopolization cases. Such a rigorous burden of proof, coupled with the de minimus prospect of eventual success, would surely render conduct, otherwise viewed as illegal, unreachable by the antitrust laws.

Third, the rule of reason has already been applied by the courts to major issues in intellectual property cases. See, for example Dawson Chemical Co. v. Rohm & Haas Co., 448 U.S. 176 (1980); Transparent-Wrap Machine Corp. v. Stokes & Smith Co., 329 U.S. 637 (1947); United States v. Studiengesellschaft Kohle, m.b.H., 670 F.2d 1122 (D.C. Cir. 1981). Accordingly, intellectual property cases should not be singled out for special treatment in an area where the courts are already providing adequate review.

Sections 3(a) and 3(b) of the bill would abolish treble damages and thus restrict antitrust awards for injuries inflicted by licensing practices to single damages. The repeal of treble damages, together with the proposed elimination of per se rules, would almost certainly prove fatal to the vigorous prosecution of an ever dwindling number of suits to be filed by private plaintiffs. Very plainly stated, flagrant violations of the antitrust laws would escape treble damages for the simple reason that the transaction involved intellectual property licensing.

In sum, the majority of the Antitrust Committee believes that S.438, if enacted, would permit intellectual property licenses to harbor price-fixing, tying arrangements and market divisions from antitrust censure.

The sweeping nature of the proposal would provide intellectual property interests significantly more favorable treatment under the antitrust laws than that accorded other interests.

REPORT ON INTELLECTUAL PROPERTY ANTITRUST
PROTECTION ACT OF 1987 AND TITLE I OF THE
OMNIBUS INTELLECTUAL PROPERTY RIGHTS
IMPROVEMENT ACT OF 1987

COMMITTEE ON ANTITRUST AND TRADE REGULATION
OF THE ASSOCIATION OF THE BAR OF THE CITY OF NEW YORK

Similar bills entitled "Intellectual Property Antitrust Protection Act of 1987" have been introduced in the House as H.R. 557 and in the Senate as S. 438, 100th Cong., 1st Sess. (1987). Under the proposed legislation, a rule-of-reason standard would be applied to agreements to convey rights in patents, copyrights, and trade secrets, including mask works, and treble damage recoveries would be eliminated.

Proponents have claimed that this legislation is necessary to assure that intellectual property is afforded treatment under the antitrust laws equal to that afforded other forms of property and that this legislation will protect intellectual property from a perceived judicial hostility. It also has been contended that the proposals are the rational capstone to the policy reflected in the National Cooperative Research Act of 1984.

We do not agree. First, the overbroad sweep of the proposal would provide intellectual property interests substantially more favorable treatment under the antitrust laws than that afforded other interests. Second, we do not agree that there is general judicial hostility to patents, copyrights, and trade secrets under the antitrust laws, and, in

any event, specific problems can be dealt with by legislation which addresses a carefully defined area. Third, the proposals go well beyond the explicit and implicit policies reflected in the National Cooperative Research Act of 1984. Fourth, the inclusion of "trade secrets" in the legislation presents questions of construction and application so substantial and dimensions so uncertain that its effect on antitrust law is totally unpredictable. Fifth, the elimination of treble damages simply singles out this area for special treatment without a demonstration of need.

The proposed legislation, in our view, cuts too broadly by eliminating per se illegality analysis of any and all anticompetitive restrictions in intellectual property license cases without an adequate showing that this serves any purpose unique to those cases. Certain restrictions, including forms of price-fixing, concerted refusals to deal and tie-ins, have been viewed by the courts as so pernicious in their effects as to warrant per se illegal treatment in all cases, including "intellectual property" cases. We know of no reason why this well-established body of case law should be overruled by legislation.

Depending upon the circumstances, it could be appropriate for some restrictions, such as the packaging of patents or the requirement for the payment of post-patent expiration royalties, to be evaluated under the rule of reason. However, by identifying anticompetitive restrictions which might well

lend themselves to a rule-of-reason analysis, we do not mean to suggest that the pending H.R. 557 and S. 438 be amended to specifically encompass such restrictions. It is better left to the courts to fashion the appropriate legal framework within which the legality of those and other restrictions is determined as the courts have been doing in the antitrust area generally.

Much of the discussion in support of applying a "rule of reason" standard to all "intellectual property" cases begins with assertions that patents and copyrights either are not "monopolies", but rather a species of property, or if they are monopolies, they are not evil or bad monopolies. The object of much of this discussion is to persuade that patent and antitrust law considerations are not antithetical, a conclusion with which we agree. See Rule, The Administration's Views: Antitrust Analysis After the Nine No-No's, 55 Antitrust L.J. 365, 367-9 (1986). See Transparent-Wrap Machine Corp. v. Stokes & Smith Co., 329 U.S. 637 (1947), where the Court treats patents as a "species of property" and rejects the application of a per se rule to a condition in a license requiring the licensee to assign improvement patents. However, the insight does not support the proposed legislation which would single out this species of "property" for treatment different from that accorded other property and transactions by precluding per se analysis and the award of treble damages in antitrust cases where the licensing of intellectual property is involved.

The proposed legislation goes further than applying the same rules as in other cases. Thus, the legislation would eliminate per se rules and treble damages in classic horizontal and vertical price-fixing cases [e.g., United States v. Line Material, Inc., 333 U.S. 287 (1948)], as well as tying cases [see, e.g., International Salt Co. v. United States, 32 U.S. 392 (1947)] solely because "intellectual property" is somehow involved. The application of per se rules to price-fixing and tying cases involving patents does not represent a judicial hostility to "intellectual property" protection. Rather, the courts simply treat intellectual property and agreements relating to it, in principle, the same as other agreements and conduct under the antitrust laws. Further, the courts have not applied only per se rules in intellectual property cases, but also have dealt with major issues in the intellectual property area under a rule of reason. Dawson Chemical Co. v. Rohm & Haas Co., 448 U.S. 176 (1980); Transparent-Wrap Machine Corp. v. Stokes & Smith Co., 329 U.S. 637 (1947); United States v. Studiengesellschaft Kohle, m. b. H., 670 F.2d 1122 (D.C. Cir. 1981).

The proposal's elimination of the per se rule in tying cases, as with price-fixing cases, singles out intellectual property for special treatment in an area in which the courts are dealing with the major issues and responding to new insights. Thus the several opinions in Jefferson Parish Hospital District No. 2 v. Hyde, 104 S. Ct. 1551 (1984),

reflect evolving judicial approaches to whether tying arrangements should be subject to a per se rule at all. See, Areeda, The Rule of Reason - A Catechism on Competition, 55 Antitrust L.J. 571, 587 (1987). Also, the Courts of Appeals currently are evolving approaches to another major tying question -- reliance on a presumption of economic power based on a patent or copyright. On the presumption issue, compare Digidyne Corporation v. Data General Corporation, 734 F.2d 1336 (9th Cir. 1984), certiorari denied, 105 S. Ct. 3534 (1985), with A.I. Root Co. v. Computer Dynamics, Inc., 806 F.2d 673 (6th Cir. 1986). In short, the courts are addressing the issues involved in tying in general, and intellectual property in particular, so that special legislation which gives intellectual property special treatment is neither necessary nor desirable.

We do not agree that there now exists a uniform judicial hostility to the protection of intellectual property rights or so great a divergence between the antitrust laws and the intellectual property laws that Congressional action is necessary. The creation of the Court of Appeals for the Federal Circuit in 1982 has brought a uniformity in the application of patent law principles to the enforcement of patent rights, and a greater judicial awareness of the importance of intellectual property rights in the development of our economy. Based on the above discussion, there does not appear to be a pervasive judicial hostility to intellectual

property, as such, and that courts have shown a willingness to apply a rule of reason to intellectual property cases.

In addition, the courts have shown themselves to be sufficiently amenable to new insights that fear of undue judicial rigidity is unwarranted. See, for example, the overruling of United States v. Arnold Schwinn & Co., 388 U.S. 365 (1967), by Continental T. V. Inc. v. GTE Sylvania, Inc., 433 U.S. 36 (1977), which should have substantial implications for vertical arrangements involving intellectual property, see, United States v. Studiengesellschaft Kohle, m. b. H., 670 F.2d 1122, 1129-30 (D.C. Cir. 1981). Even in the area of tying arrangements, Jefferson Parish reveals the judicial process to be in such a state of evolution and adjustment that Professor Areeda has stated, "There is no per se rule against tying now." Areeda, supra.

Further, where there has been concern about a specific application of the antitrust laws to patent matters, Congress has been able to respond with legislation focused on the specific concern, rather than placing all intellectual property cases in a class by themselves. See Mercoird Corp. v. Mid-Continent Investment Co., 320 U.S. 661 (1944), which was followed by the amendment to 35 U.S.C. 271 in 1952.

In addition to a claim of actual judicial hostility, the proponents claim that perceived judicial hostility has served as a deterrent to innovation. At the same time, commentators have opined that the empirical basis for the "deterrent" theory

is largely nonexistent. Ordovery, Economic Foundations and Considerations In Protecting Industrial and Intellectual Property, 53 Antitrust L.J. 503, 504 (1984). ("... there is very little hard evidence..."); Scherer, comment, 53 Antitrust L.J. 545. Cf. Taylor, Analyzing Licensee-Licensor Relationships: The Methodology Revisited, 53 Antitrust L.J. 577, 579 (1984).

It also has been suggested that the proposed legislation is but a rational extension of the licensing policy expressed in the National Cooperative Research Act of 1984. (See, e.g., Comments of Senator Hatch, Cong. Rec. S. 1597, Feb. 3, 1987.) The Committee does not agree. The National Cooperative Research Act excluded from its immunizing effect those agreements related to the marketing of products which utilized the new research. As a practical matter, the 1984 legislation preserved the application of per se rules and recovery of treble damages in those cases in which the current proposals would eliminate per se rules and treble damages. It is probable that after the 1984 Act, except for the elimination of treble damages in a very limited area, the law remained unchanged because the agreements it covered probably were not violations of the antitrust laws prior to its enactment. See Baker, Restating Law and Refining Remedies: The Trading Company Act, The Joint Research Act, And The Local Government Antitrust Act, 55 Antitrust L.J. 499, 510-11 (1986).

In contrast, the proposed bills reflect a major shift in

the approach to antitrust and "intellectual property." It is reflected in a statement by the Hon. Charles F. Rule, the designee to be Assistant Attorney General in charge of the Justice Department's Antitrust Division, in support of a "rule of reason" approach to intellectual property cases. Rule, supra, 55 Antitrust L.J. at 370:

"Consequently, antitrust enforcers and courts should be slow to condemn patent licenses. Unless the restriction is clearly anticompetitive under the particular circumstances, it should not be condemned. Certainly, if a patent license is a 'sham' and has nothing to do with the exploitation of the underlying patent(s) but everything to do with providing a guise for a price-fixing cartel, the license violates the antitrust laws. If, for example, a license for a pocket calculator patent sets the price at which the parties will sell ball-point pens, one can conclude 'in the twinkling of an eye' that the restriction is unreasonable and thus illegal. Such shams are rare, to say the least, and the vast majority of licenses require a more exhaustive rule of reason analysis."

Unlike the National Cooperative Research Act of 1984, the proposed bill deals with more than the entrepreneurs' fears that arise from a perhaps mistaken perception of judicial hostility. The proposed bill not only would preclude the application of per se analysis to "sham" restrictions, it also would eliminate treble damages in those cases. Nothing in the current bill excludes even this extreme kind of a case from its coverage. The proposed bill would make fundamental changes, and it is not a mere extension of the policy underlying the National Cooperative Research Act of 1984.

The legislation also presents serious problems of construction, particularly with its reference to "trade secrets." There is no federal statutory definition of "trade secret" or a body of federal "trade secret" law. While there are some basic principles of trade secret law, what constitutes a trade secret is dependent on state law which surely is not uniform. The legislation, as drafted, would require either that a federal body of trade secret (and "know-how") law be developed solely for antitrust purposes or that the results under the new legislation depend upon the substantive law of trade secrets of the several states. Thus, whether per se rules are applicable and whether conduct is subject to treble damages could vary from state to state.

Mr. Rule recognizes that agreements relating to patents which are proffered to justify the adoption of the proposal do not necessarily apply to "know-how" or, presumably, to trade secrets. He described "know-how" as a "broad and amorphous concept"; "trade secrets" also is a concept with uncertain dimensions. He recognized the danger of a positive evil from shielding know-how arrangements which simply may be a guise to protect a cartel. Rule, supra, at 372. Whatever is ultimately decided with respect to the proposal, trade secrets and know-how licenses should not be covered.

The proposal presents still another danger. By its terms, it is applicable whenever there is a "patent" or "copyright" involved, and as noted, whenever the undefined "trade secret"

is involved. Thus, even "sham" transactions would be protected by the legislation. Therefore, the legislation would provide an incentive to fashion transactions to involve patents, copyrights or "trade secrets" so as to avoid treble damages and per se rules. In view of Mr. Rule's previously cited comments and the statutory language itself, these dangers are real and should be avoided.

Perhaps the most radical departure from existing law in the proposed bill is the elimination of treble damages. Unlike the National Cooperative Research Act, which dealt with situations in which the likelihood of finding a pre-enactment antitrust violation was not great, see Baker, supra, the proposed bill would eliminate treble damages where violations under current law are likely to be found (e.g., price-fixing, some tying arrangements) and where there can be no legitimate doubt on the part of the actors that they are in violation. Simply stated, obvious violations of the antitrust laws would be immune from treble damages simply because the transaction involved or was fashioned to involve intellectual property licensing. On June 4, 1985, this Committee examined the treble damage remedy in an extensive memorandum submitted to the Senate Committee on the Judiciary and concluded that mandatory treble damages should be replaced by judicial discretion with statutory standards. The legislative proposal we are now considering would totally eliminate treble damages even in the most egregious cases, so long as intellectual property was

involved. The question of whether treble damages is an appropriate antitrust remedy in some, all or no instances is a proper subject of concern but the determination should not be made on the ad hoc basis represented by these proposals.

CONCLUSION

1. Insofar as the proposals are based on a fear of actual or perceived judicial hostility to the public interest in intellectual property or the inability of the Courts to deal with intellectual property issues in a rational manner, the fears are unfounded and the proposals are unnecessary.

2. Insofar as the proposals provide special antitrust treatment for "intellectual property," there is no demonstrated factual basis to warrant such a departure from current law. In any event, the problems presented by construing "trade secrets" or know-how and the uncertainty of the coverage of these terms should be resolved by eliminating know-how and trade secrets from the proposal if it is adopted.

3. The elimination of treble damages and the elimination of per se rules in vertical and horizontal price-fixing cases and in tying arrangements are all issues in the larger

antitrust debate and no reason appears for removing all intellectual property licensing cases from the broader, comprehensive examination of these subjects under the antitrust laws in general.

Respectfully submitted,

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NOTES

TYING ARRANGEMENTS AND THE COMPUTER
INDUSTRY: *DIGIDYNE CORP. V. DATA
GENERAL CORP.*

In the recent case of *Digidyne Corp. v. Data General Corp.*,¹ the United States Court of Appeals for the Ninth Circuit held that Data General's refusal to license its copyrighted computer software to those who did not purchase its hardware was an unlawful tying arrangement.² The court of appeals found that Data General's market power in the market for the tying product—computer software—was sufficient to establish a per se violation of section 1 of the Sherman Antitrust Act³ and section 3 of the Clayton Act.⁴ The trial court had already found that there was no business justification for Data General's actions,⁵ and this determination was affirmed by the court of appeals.⁶ With two Justices filing a written dissent, the Supreme Court denied certiorari in the case.⁷ The *Data General* decision opens many firms in the highly competitive computer industry to potential antitrust liability for "tying" hardware and software products.

This note reviews the law of tying arrangements and the opinions in the *Data General* case.⁸ The note then examines the Ninth Circuit's reasoning in light of recent changes in the attitudes of courts, legal commentators, and economists toward the possible efficiency effects of tying arrangements. It finds that the *Data General* holding can be faulted on

1. 734 F.2d 1336 (9th Cir. 1984), cert. denied, 105 S. Ct. 3534 (1985).

2. *Id.* at 1338.

3. 15 U.S.C. § 1 (1982) provides, in relevant part, that "[e]very contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal."

4. 15 U.S.C. § 14 (1982) provides, in relevant part:

It shall be unlawful for any person engaged in commerce, in the course of such commerce, to lease or make a sale or contract for sale of goods, . . . whether patented or unpatented, . . . on the condition, agreement, or understanding that the lessee or purchaser thereof shall not use or deal in the goods . . . of a competitor or competitors of the lessor or seller, where the effect of such lease, sale, or contract . . . may be to substantially lessen competition or tend to create a monopoly in any line of commerce.

5. *Data General*, 734 F.2d at 1339 n.1.

6. *Id.* at 1343-44, 1347.

7. 105 S. Ct. 3534 (1985).

8. See *infra* notes 12-39 and accompanying text.

several grounds. First, the Ninth Circuit failed to require a showing of market power sufficient to invoke the per se rule.⁹ Second, the presumption of market power arising from copyright proprietorship should be treated as rebuttable, or merely as persuasive evidence, rather than as an irrebuttable presumption.¹⁰ Finally, the trial court did not give adequate consideration to the possible business justifications for selling computer hardware and software as a single package.¹¹ Because it applied mechanical rules to complex economic issues, the Ninth Circuit imposed liability without a sufficient showing that competition or consumer welfare was adversely affected by the tying arrangement. *Data General* thus threatens to impose treble damage liability on all firms in the computer industry that engage in the common practice of selling software-hardware packages. The note concludes that the imposition of such liability is unjustified in light of Supreme Court precedent and the underlying purposes of the antitrust laws.

I. THE PER SE RULE AGAINST TYING ARRANGEMENTS

Section 1 of the Sherman Act prohibits "[e]very contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce."¹² Cases arising under section 1 are generally decided under the "rule of reason."¹³ This standard "requires the factfinder to decide whether under all the circumstances of the case the restrictive practice imposes an unreasonable restraint on competition."¹⁴ If a restraint is found to promote competition, it is upheld.¹⁵ In the interest of judicial economy, however, courts have fashioned per se rules against practices that are "manifestly anticompetitive."¹⁶ Where this rule is

9. See *infra* notes 40-102 and accompanying text.

10. See *infra* notes 103-33 and accompanying text.

11. See *infra* notes 134-84 and accompanying text.

12. Sherman Act, ch. 647, § 1, 26 Stat. 209, 209 (1890) (codified as amended at 15 U.S.C. § 1 (1982)).

13. *Arizona v. Maricopa County Medical Soc'y*, 457 U.S. 332, 342-43 (1982); *Standard Oil Co. v. United States*, 221 U.S. 1, 60 (1911). For a discussion of the nature and history of the rule of reason, see *National Soc'y of Professional Eng'rs v. United States*, 435 U.S. 679, 688-92 (1978).

14. *Arizona v. Maricopa County Medical Soc'y*, 457 U.S. 332, 343 (1982) (citing *Chicago Bd. of Trade v. United States*, 246 U.S. 231, 238 (1918) (Brandeis, J.)).

15. *National Soc'y of Professional Eng'rs v. United States*, 435 U.S. 679, 691 (1978).

16. *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 50 (1977); see also *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 104 S. Ct. 1551, 1560 n.25 (1984) (discussing rationale for per se rules in antitrust cases). The per se rule makes certain activities, including certain tying arrangements, illegal without any showing of unreasonable effect on competition. *Fortner Enters. v. United States Steel Corp.*, 394 U.S. 495, 498 (1969) [hereinafter cited as *Fortner I*]; *Northern Pac. Ry. v. United States*, 356 U.S. 1, 5-6 (1958) ("[T]here are certain agreements or practices which because of their pernicious effect on competition and lack of any redeeming virtue are conclusively presumed to be unreasonable and therefore illegal without elaborate inquiry as to the precise harm they have

applied, a practice is condemned without consideration of its reasonableness.¹⁷

A tying arrangement, or "tie-in," is "an agreement by a party to sell one product but only on the condition that the buyer also purchases a different (or tied) product, or at least agrees that he will not purchase that product from any other supplier."¹⁸ The courts have held that the use of market power or leverage in one market to influence another market "generally serve[s] no legitimate business purpose that cannot be achieved in some less restrictive way."¹⁹ As a result, tying arrangements are assumed to be anticompetitive and are therefore condemned as per se violations of section 1 of the Sherman Act and section 3 of the Clayton Act.²⁰

It is important to note, however, that the courts have normally applied a "partial per se" rule to tying arrangements:²¹

caused or the business excuse for their use."'). For a discussion of the validity of the per se rule against tie-ins, see *infra* notes 60-77 and accompanying text.

17. See, e.g., *Arizona v. Maricopa County Medical Soc'y*, 457 U.S. 332, 343-44 (1982); *Broadcast Music, Inc. v. CBS*, 441 U.S. 1, 7-8 (1979); *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 49-50 (1977); *Northern Pac. Ry. v. United States*, 356 U.S. 1, 5 (1958). The rationale for the per se rule is to avoid burdensome market inquiry "where the likelihood of anticompetitive conduct is so great as to render unjustified the costs of determining whether the particular case at bar involves anticompetitive conduct." *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 104 S. Ct. 1551, 1560 n.25 (1984).

18. *Northern Pac. Ry. v. United States*, 356 U.S. 1, 5-6 (1958).

19. *Fortner I*, 394 U.S. 495, 503 (1969). The leverage theory is discussed and criticized *infra* notes 46-54 and accompanying text. *

20. See *Northern Pac. Ry. v. United States*, 356 U.S. 1, 5 (1958) (tying arrangements are per se violations of § 1 of the Sherman Act); *International Salt Co. v. United States*, 332 U.S. 392, 396 (1947) ("[I]t is unreasonable, per se, to foreclose competitors from any substantial market."). An extensive legislative and case history supports the per se rule against tying arrangements. See *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 104 S. Ct. 1551, 1557 nn.14-15 (1984) (citing cases and legislative history supporting the per se rule).

21. E.g., *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 104 S. Ct. 1551, 1558-61 (1984) (discussing necessary conditions for the application of the per se rule against tie-ins); *Fortner I*, 394 U.S. 495, 498 (1969) (tie-ins are per se illegal, "at least when certain prerequisites are met"). As the Supreme Court recently noted:

[T]here is often no bright line separating per se from Rule of Reason analysis. Per se rules may require considerable inquiry into market conditions before the evidence justifies a presumption of anticompetitive conduct. For example, although the Court has spoken of a "per se" rule against tying arrangements, it has also recognized that tying may have procompetitive justifications that make it inappropriate to condemn without considerable market analysis.

NCAA v. Board of Regents, 104 S. Ct. 2948, 2962 n.26 (1984); see ABA ANTITRUST SECTION, ANTITRUST LAW DEVELOPMENTS 89-90 (2d ed. 1984) (some business justifications are considered by the courts despite the per se rule); R. GIVENS, ANTITRUST: AN ECONOMIC APPROACH § 9.02 (1983) (discussing market power and business justification issues that are considered despite per se label); ANTITRUST ADVISER 94 (C. Hills 2d ed. 1978) (courts apply near-per se or pseudo-per se rule) [hereinafter cited as C. HILLS]; W. HOLMES, INTELLECTUAL PROPERTY AND ANTITRUST LAW § 8.02, at 5 (1983) (reference to per se standard somewhat misleading); E. ROCKEFELLER, ANTITRUST COUNSELING FOR THE 1980S, at 82-83 (1983) (courts consider business justifications).

[A]s a practical matter, the need to conduct a number of market-related inquiries in order to invoke the per se rule and the willingness of the courts to consider justifications for the challenged conduct result in an analysis of economic effect that in some respects approaches a rule of reason inquiry.²²

In order to invoke this partial per se rule, the plaintiff must prove the following: (1) there are two separate products; (2) the sale of one product is conditioned on or "tied" to the sale of the other product; (3) the seller has enough market power in the market for the tying product "to restrain competition appreciably" in the market for the tied product; and (4) a substantial amount of commerce in the tied product is affected by the tie-in.²³ Courts of appeals in several circuits have also required the plaintiff to establish that competition in the market for the tied product has actually been foreclosed.²⁴

A large number of cases illustrate the application of the partial per se rule. See, e.g., *Fortner I*, 394 U.S. 495, 506 (1969) ("It may turn out [on remand] that the arrangement here serves legitimate business purposes . . ."), *Betaseed, Inc. v. U. & I, Inc.*, 681 F.2d 1203, 1215 (9th Cir. 1982) (per se rule against tying still "permits the defendant to offer justifications for undertaking the tie") (quoting *Phonetele, Inc. v. American Tel. & Tel. Co.*, 664 F.2d 716, 738-39 (9th Cir. 1981), *cert. denied*, 459 U.S. 1145 (1983)), *Hirsh v. Martindale-Hubbell, Inc.*, 674 F.2d 1343, 1347 nn.16-17 (9th Cir.) (noting that even under per se rule procompetitive nature of a tie-in is considered), *cert. denied*, 459 U.S. 973 (1982); *David R. McGeorge Car Co. v. Leyland Motor Sales, Inc.*, 504 F.2d 52, 58 (4th Cir. 1974) (transaction "does not fall within that classification of arrangements which have no lawful business objective"), *cert. denied*, 420 U.S. 992 (1975); *Polytechnic Data Corp. v. Xerox Corp.*, 362 F. Supp. 1, 9 (N.D. Ill. 1973) (accepting efficiency justification for tie-in); *Susser v. Carvel Corp.*, 332 F.2d 505, 519-20 (2d Cir. 1964) (protection of goodwill accepted as business justification), *cert. dismissed*, 381 U.S. 125 (1965); *Baker v. Simmons Co.*, 307 F.2d 458, 468-69 (1st Cir. 1962) (upholding tie-in that maintained trademark holder's goodwill); *Dehydrating Process Co. v. A. O. Smith Corp.*, 292 F.2d 653, 655-57 (1st Cir.) (accepting goodwill/efficiency justification), *cert. denied*, 368 U.S. 931 (1961); *United States v. Jerrold Elecs. Corp.*, 187 F. Supp. 545 (E.D. Pa. 1960) (accepting "developing industry" justification in case of tie-in of CATV equipment and service), *aff'd per curiam*, 365 U.S. 567 (1961).

22. ABA ANTITRUST SECTION, *supra* note 21, at 77.

23. See *Digidyne Corp. v. Data General Corp.*, 734 F.2d 1336, 1338 (9th Cir. 1984), *cert. denied*, 105 S. Ct. 3534 (1985); see also *Fortner I*, 394 U.S. 495, 498-99 (1969); *Hirsh v. Martindale-Hubbell, Inc.*, 674 F.2d 1343, 1346-47 (9th Cir.), *cert. denied*, 459 U.S. 973 (1982). The elements of the per se rule are generally the same for Clayton and Sherman Act suits. See *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 104 S. Ct. 1551, 1564 n.39 (1984) ("[W]ith respect to the definition of tying the standards used by the two statutes are the same"); *Spartan Grain & Mill Co. v. Ayers*, 581 F.2d 419, 428 (5th Cir. 1978) (market power is required under both Sherman and Clayton Acts), *cert. denied*, 444 U.S. 831 (1979); *Moore v. Jas. H. Matthews & Co.*, 550 F.2d 1207, 1214 (9th Cir. 1977) (elements of per se rule for Sherman and Clayton Acts appear "virtually identical"); E. ROCKEFELLER, *supra* note 21, at 81 (similar standards applied); E. KINTNER, AN ANTITRUST PRIMER 55 (1964) ("difference [in elements of the per se rule] may no longer exist in the field of tie-in sales"). Some earlier decisions interpreted the Clayton Act as condemning tying arrangements on a lesser showing than that required under section 1 of the Sherman Act. See, e.g., *Times-Picayune Publishing Co. v. United States*, 345 U.S. 594, 608-09 (1953).

24. E.g., *Shop & Save Food Mkts., Inc. v. Pneumo Corp.*, 683 F.2d 27, 30 (2d Cir.), *cert. denied*, 459 U.S. 1038 (1982); *Bob Maxfield, Inc. v. American Motors Corp.*, 637 F.2d 1033, 1037 (5th Cir.), *cert. denied*, 454 U.S. 860 (1981); *Yeutsch v. Texaco, Inc.*, 630 F.2d 46, 57-58 (2d Cir.

II. *DIGIDYNE CORP. V. DATA GENERAL CORP.*

Data General is one of approximately one hundred manufacturers of general-purpose minicomputers and microprocessors. It sells a central processing unit (CPU) called NOVA and an accompanying line of operating system software called RDOS. Digidyne Corp. and the other plaintiffs are manufacturers of competing CPUs (known as NOVA emulators) that are compatible with the RDOS software. After Data General refused to license its software for use with the NOVA emulators, Digidyne Corp. and other competitors filed suit, alleging that Data General's requirement that purchasers of RDOS also buy NOVA was a tying arrangement in violation of the Sherman and Clayton Acts.²⁵

The trial court granted summary judgment in favor of the plaintiffs on three of the four elements of the per se rule. The trial court found that the software and the CPU were separate products,²⁶ purchasers were required to buy both,²⁷ and the tie-in affected a "not insubstantial" amount of interstate commerce.²⁸ In addition, the court rejected three

1980); *Driskill v. Dallas Cowboys Football Club, Inc.*, 498 F.2d 321, 323 (5th Cir. 1974); *Coniglio v. Highway Servs., Inc.*, 495 F.2d 1286, 1291-92 (2d Cir.), *cert. denied*, 419 U.S. 1022 (1974); *see also* *Boddicker v. Arizona State Dental Ass'n*, 680 F.2d 66, 67 (9th Cir.) (membership link between a national dental association and local and state societies not a tying arrangement because there is no market in the "tied product" for the challenged membership requirements to restrain), *cert. denied*, 459 U.S. 837 (1982); *Community Builders, Inc. v. City of Phoenix*, 652 F.2d 823, 830 (9th Cir. 1981) (municipality's conditioning of building permit on water hookup not a tying arrangement because no competitive market for water services existed). For a discussion of the elements of the per se rule in tie-in cases, *see* R. GIVENS, *supra* note 21, § 9.02.

25. *In re Data General Corp. Antitrust Litig.*, 529 F. Supp. 801, 805 (N.D. Cal. 1981), *rev'd in part*, 734 F.2d 1336 (9th Cir. 1984), *cert. denied*, 105 S. Ct. 3534 (1985) [hereinafter cited as *Data General II*].

26. *In re Data General Corp. Antitrust Litig.*, 490 F. Supp. 1089, 1104-06 (N.D. Cal. 1980), *aff'd in relevant part*, 734 F.2d 1336 (9th Cir. 1984), *cert. denied*, 105 S. Ct. 3534 (1985) [hereinafter cited as *Data General I*]. The court concluded that, despite the fact that the two products must be used together, the CPU and the software need not come from the same seller. *Id.* Whether there are two separate products depends upon the existence of two separate product markets, not upon the functional relationship between the two products. *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 104 S. Ct. 1551, 1562 (1984); *see infra* note 183. Although seemingly straightforward, the standards for determining whether two products are indeed separate are vague. *See* R. POSNER, *ANTITRUST LAW: AN ECONOMIC PERSPECTIVE* 181 (1976) (no logical way to determine whether there are one or two products unless cost justifications are implicitly taken into account).

27. *Data General I*, 490 F. Supp. at 1107.

28. *Id.* at 1116-17. The court also found that the plaintiffs had shown that they had suffered antitrust injury as a result of the defendant's tying practices. *Id.* at 1117-19.

Under the "not insubstantial" test, anything more than a de minimis dollar amount is sufficient. *Fortner I*, 394 U.S. 495, 501 (1969). Dollar volumes in the \$50,000 to \$100,000 range have been regarded as sufficient. *See Aamco Automatic Transmissions v. Taylor*, 407 F. Supp. 430, 436 (E.D. Pa. 1976).

business justifications offered by Data General.²⁹ A jury trial was held on the limited issue of whether there was sufficient economic power in the tying product market to restrain competition appreciably in the market for the tied product.³⁰ The jury found that Data General possessed sufficient economic power, but the trial court granted Data General's motion for a judgment n.o.v.³¹ The court concluded that "the evidence cannot reasonably support a finding that Data General possessed economic power" sufficient to restrain competition.³²

The United States Court of Appeals for the Ninth Circuit reversed the district court's conclusion on the sufficiency of market power.³³ To establish a per se case, the court reasoned, the plaintiff need not show "power over the whole market for the tying product," but merely the ability to induce some customers to purchase the second product when they would not have done so in a competitive market.³⁴ The court of appeals found that Data General had the ability to "force" buyers to accept the tying arrangement, and justified this finding on several grounds. First, it found that "defendant's RDOS was distinctive and particularly desirable to a substantial number of buyers."³⁵ Second, the court recited the rule that a defendant's possession of a copyright on the tying product creates a presumption of market power.³⁶ Finally, having found that RDOS was "unique as a matter of law," the court asserted that the market power thus conferred on Data General was magnified because buyers were "locked in."³⁷ The lock-in allegedly gave Data

29. Data General I, 490 F. Supp. 1089, 1120-24 (N.D. Cal. 1980), *aff'd in relevant part*, 734 F.2d 1336 (9th Cir. 1984), *cert. denied*, 105 S. Ct. 3534 (1985). The business justification question is discussed *infra* notes 134-84 and accompanying text.

30. Digidyne Corp. v. Data General Corp., 734 F.2d 1336, 1338 (9th Cir. 1984), *cert. denied*, 105 S. Ct. 3534 (1985).

31. Data General II, 529 F. Supp. at 821. In the alternative, the court granted a motion for a new trial. *Id.*

32. *Id.*

33. Digidyne Corp. v. Data General Corp., 734 F.2d 1336, 1346-47 (9th Cir. 1984), *cert. denied*, 105 S. Ct. 3534 (1985). The Ninth Circuit's decision can be partly explained by its deference to the jury's conclusion at trial. See *id.* at 1341 (finding "substantial evidence" to support the jury's findings). Nevertheless, the court went further, holding that uniqueness was shown "as a matter of law." *Id.* at 1342-43. The court stated its opinion in broad language, and apparently did not intend to limit the decision to its facts.

34. *Id.* at 1341 (citing Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 104 S. Ct. 1551, 1559 n.20 (1984)).

35. Data General, 734 F.2d at 1341.

36. *Id.* at 1341-42; see Jefferson Parish Hosp. Dist. No. 2 v. Hyde, 104 S. Ct. 1551, 1560 (1984) ("it is fair to presume" market power from patents and other legal monopolies); United States v. Loew's Inc., 371 U.S. 38, 45 (1962) (same); see also United States Steel Corp. v. Fortner Enters., 429 U.S. 610, 620 (1977) (copyright confers "some advantage[s] not shared by . . . competitors in the market for the tying product") [hereinafter cited as Fortner II].

37. Digidyne Corp. v. Data General Corp., 734 F.2d 1336, 1342-43 (9th Cir. 1984), *cert. denied*, 105 S. Ct. 3534 (1985).

General power over its customers, companies that build complete computer systems around RDOS. Such a purchaser would presumably be forced to abandon its entire computer system if it switched to a competing, and incompatible, brand of software.³⁸ Hence, the expense and inconvenience involved in switching from RDOS to a competing operating system gave Data General an advantage not shared by its competitors.³⁹

III. MARKET POWER IN TYING CASES

The *Data General* court's willingness to impose per se liability and treble damages⁴⁰ was based essentially on two findings: (1) many buyers accepted Data General's mandatory software-hardware package and (2) the tying product, RDOS, was copyrighted. Software-hardware packages are common in the computer industry.⁴¹ Because computer hardware and software are generally protected by patents and copyrights, respectively,⁴² many computer manufacturers may be exposed to antitrust liability as a result of *Data General*. Yet these companies face intense competition from a large number of American and foreign producers.⁴³ Rapid technological change encourages the constant replacement of leading products with newer and more advanced competitors.⁴⁴ The Ninth Circuit's finding of market power was inadequate under the legal rules governing tying arrangements and in light of the economic underpinnings of the antitrust laws. It is widely acknowledged that, in defining the legal standards for market power, the law should recognize the economic realities of the marketplace.⁴⁵ A more stringent

38. *Id.* The lock-in theory is criticized *infra* notes 90-91 and accompanying text.

39. See *Digidyne Corp. v. Data General Corp.*, 734 F.2d 1336, 1342-43 (9th Cir. 1984), *cert. denied*, 105 S. Ct. 3534 (1985).

40. Treble damages are authorized by 15 U.S.C. § 15(a) (1982) ("[A]ny person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws . . . shall recover threefold the damages by him sustained . . .").

41. The specialized computer magazines describe some of the numerous software-hardware packages that are offered on the market. *E.g.*, *COMPUTER BUYER'S GUIDE & HANDBOOK*, Jan. 1985, at 40, 43-105; Enright, *Preview: The Kaypro 16*, *PROFILES*, Feb. 1985, at 74, 76, 79.

42. Computer programs (software) receive limited copyright protection. See *Data General II*, 529 F. Supp. 801, 816 (N.D. Cal. 1981), *rev'd in part on other grounds*, 734 F.2d 1336 (9th Cir. 1984), *cert. denied*, 105 S. Ct. 3534 (1985). See generally Samuelson, *CONTU Revisited: The Case Against Copyright Protection for Computer Programs in Machine-Readable Form*, 1984 *DUKE L.J.* 663.

43. In *Data General II*, for example, the trial court noted that Data General had over one hundred competitors in the market for operating system software. *Data General II*, 529 F. Supp. at 813. The market was described as "broad, dynamic, [and] highly competitive." *Id.*

44. See *id.*

45. A recognition that the intellectual and legal basis of the antitrust laws lies in economic theory is crucial. See, e.g., *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 104 S. Ct. 1551, 1559-60 (1984) (discussing efficiency and consumer welfare as goals of the antitrust laws); *Arizona v. Maricopa County Medical Soc'y*, 457 U.S. 332, 366-67 (1982) (Powell, J., dissenting) (the courts are

and rigorous definition of market power would prevent the imposition of liability on firms that do not have the economic power to restrain competition. It would also be consistent with recent Supreme Court rulings that, unlike *Data General*, emphasize the importance of market power in deciding antitrust cases.

A. *The Importance of Market Power: Traditional and Economic Approaches.*

The requirement of a strong showing of market power is consistent with the traditional "leverage" rationale for attacking tying arrangements. As Justice White has noted, leverage "is the use of power over one product to attain power over another, or otherwise distort freedom of trade and competition in the second product."⁴⁶ If there is no economic power or control over the tying product market, one seller's decision to sell two products as a package does not have any anticompetitive

bound to interpret the broad mandate of the antitrust laws for the benefit of consumers); *Reiter v. Sonotone Corp.*, 442 U.S. 330, 343 (1979) (antitrust laws are a "consumer welfare prescription"); *Broadcast Music, Inc. v. CBS*, 441 U.S. 1, 19-20 (1979) (discussing the importance of efficiency effects in determining the applicability of the per se rule); *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 488 (1977) (antitrust should protect competition, not competitors); I P. AREEDA & D. TURNER, *ANTITRUST LAW* § 104 (1978) (economic efficiency is paramount consideration in antitrust cases); R. BORK, *THE ANTITRUST PARADOX* 81-89 (1978) (same); W. LETWIN, *LAW AND ECONOMIC POLICY IN AMERICA* 3 (1965) (describing the Sherman Act as "economic policy [to facilitate competition] imposed by a general law"); Holmes, *Antitrust as a Flexible Charter for Competitive Markets*, in ABA ANTITRUST SECTION, *INDUSTRIAL CONCENTRATION AND THE MARKET SYSTEM* 17, 18 (1979) ("[T]he central and fundamental objective of the antitrust laws is to ensure the preservation and perpetuation of the competitive market economy."); Bork, *Legislative Intent and the Policy of the Sherman Act*, 9 J.L. & ECON. 7, 7 (1966) (Congress's intent in passing Sherman Act was to promote consumer welfare). In a landmark decision, the Supreme Court recognized the economic evidence favoring territorial restrictions on franchises and therefore overturned the per se rule against that form of vertical restraint. *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 54-58 (1977); see R. GIVENS, *supra* note 21, § 31.01 ("The increased recognition of the importance of economic factors in antitrust . . . contributed to the expansion of the rule of reason in the *GTE Sylvania* case and the notion that per se rules only apply where their purposes also apply."); Williamson, *Symposium on Antitrust Law and Economics: Introduction*, 127 U. PA. L. REV. 918, 920 (1979) (*GTE Sylvania* illustrates the Court's willingness to consider efficiency and transaction-cost effects of business practices).

The Supreme Court was also receptive to economic efficiency arguments in a recent case involving resale price maintenance. See *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752, 762 (1984) (discussing the importance of actual market impact); see also Easterbrook, *Vertical Arrangements and the Rule of Reason*, 53 ANTITRUST L.J. 135, 169-71 (1984) (*Monsanto* "largely reads as if the Court has adopted the economic approach to restricted distribution."). *Monsanto* also casts doubt on the applicability of the per se rule to resale price maintenance. See Easterbrook, *supra*, at 171.

46. *Fortner I*, 394 U.S. 495, 512-14 (1969) (White, J., dissenting); see *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 104 S. Ct. 1551, 1558 (1984). One commentator has argued that the leverage theory of tie-ins is similar to the transfer-of-power theory in predatory pricing. See C. HILLS, *supra* note 21, at 192-93 (W. Liebler ed. Supp. 1984).

effects.⁴⁷ In *Jefferson Parish Hospital District No. 2 v. Hyde*,⁴⁸ for example, the Supreme Court refused to apply the per se rule against a hospital's requirement that its patients purchase preselected anesthesiological services. Viewing market power as a necessary condition for the existence of anticompetitive "forcing,"⁴⁹ the court held that per se treatment is inappropriate where no strong showing of market power is made.⁵⁰

Although still influential, the leverage view of tie-ins has been widely criticized by commentators and economists.⁵¹ George Stigler's

47. *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 104 S. Ct. 1551, 1558, 1565 (1984); see also *id.* at 1571-72 (O'Connor, J., concurring) (noting that, absent market power in tying product market, tie-in will in fact be "pro-competitive"); Fortner II, 429 U.S. 610, 620 (1977) (raising issue of whether seller has power within the tying product market to raise prices or require purchasers to accept burdensome terms); Fortner I, 394 U.S. 495, 503-04 (1969) ("[T]he proper focus of concern is whether the seller has the power to raise prices, or impose other burdensome terms such as a tie-in, with respect to any appreciable number of buyers within the market."). One commentator has noted that "when . . . firms lack market power . . . they cannot sustain deleterious practices. Rival firms will offer the consumers better deals. The process of rivalry is sufficient insurance. Rivals' better offers will stamp out bad practices faster than the judicial process can." Easterbrook, *supra* note 45, at 159. A tie-in by a firm with little or no market power can benefit consumers by increasing the number of price-quality options available, facilitating the introduction of new products, alleviating imperfect information problems, and frustrating efforts to form cartels. See *id.* at 146, 149-50.

48. 104 S. Ct. 1551 (1984).

49. *Id.* at 1558-60.

50. *Id.* at 1560-61, 1565.

51. "Although the replacement of leverage by price discrimination in the theory of tie-ins has been a part of the economic literature for almost twenty years, it has had virtually no impact on public policy." R. POSNER, *supra* note 26, at 174 (footnote omitted); see D. ARMENTANO, *ANTITRUST AND MONOPOLY: ANATOMY OF A POLICY FAILURE* 200 (1982) ("[T]here is no practical way to 'leverage' market power from one market to another."); R. BORK, *supra* note 45, at 372 ("The law's theory of tying arrangements is merely another example of the discredited transfer-of-power theory, and perhaps no other variety of that theory has been so thoroughly and repeatedly demolished in the legal and economic literature."); W. BOWMAN, *PATENT AND ANTITRUST LAW*, at ix, 55-58, 157-58 (1973) (criticizing the leverage theory in the patent-antitrust cases); Easterbrook, *supra* note 45, at 143-44 (criticizing the leverage theory); D. GIFFORD & L. RASKIND, *FEDERAL ANTITRUST LAW* 183 (1983) (criticizing "leverage" as assuming ability to transfer or extend market power); C. HILLS, *supra* note 21, at 192-94 (W. Liebler ed. 1984 Supp.) (leverage view of tie-ins is subject to increasing challenge); R. POSNER, *supra* note 26, at 172 ("One striking deficiency of the traditional, 'leverage' theory of tie-ins . . . is the failure to require any proof that a monopoly of the tied product is even a remotely plausible consequence of the tie-in."); Hovenkamp, *Tying Arrangements and Class Actions*, 36 VAND. L. REV. 213, 227-31 (1983) (concluding that the leverage theory "has no economic merit" and is "fallacious"); Williamson, *supra* note 45, at 919 (describing Harvard School's leverage theory as "discredited"). For a general discussion of the leverage theory, see P. AREEDA, *ANTITRUST ANALYSIS* 735 (3d ed. 1981); Bowman, *Tying Arrangements and the Leverage Problem*, 67 YALE L.J. 19 (1957); Burstein, *A Theory of Full-Line Forcing*, 55 NW. U.L. REV. 62 (1960); Markovits, *Tie-ins, Reciprocity, and the Leverage Theory*, 76 YALE L.J. 1397 (1967).

The notion that tie-ins are barriers to entry is a related notion that rests on the same premises as the leverage theory. R. BORK, *supra* note 45, at 374-75; see W. BOWMAN, *supra*, at 118 ("The 'barriers to entry' argument . . . is again merely a variation of the leverage example."); R. POSNER, *supra* note 26, at 176 (criticizing the entry barrier argument); Posner, *The Chicago School of Antitrust Analysis*, 127 U. PA. L. REV. 925, 929-30 (1979) (criticizing leverage and barrier to entry theories).

critique of *United States v. Loew's Inc.*⁵² provides an example:

One film, Justice Goldberg cited *Gone With the Wind*, is worth \$10,000 to the buyer, while a second film, the Justice cited *Getting Gertie's Garter*, is worthless to him. The seller could sell the one for \$10,000, and throw away the second, for no matter what its cost, by-gones are forever by-gones. Instead the seller compels the buyer to take both. But surely he can obtain no more than \$10,000, since by hypothesis this is the value of both films to the buyer. Why not, in short, use his monopoly power directly on the desirable film? It seems no more sensible, on this logic, to blockbook the two films than it would be to compel the exhibitor to buy *Gone With the Wind* and seven Ouija boards, again for \$10,000.⁵³

The weakness of the leverage theory has only recently been noted by the courts:

The existence of a tied product normally does not increase the profit that the seller with market power can extract from sales of the *tying* product. A seller with a monopoly on flour, for example, cannot increase the profit it can extract from flour consumers simply by forcing them to buy sugar along with their flour. Counterintuitive though that assertion may seem, it is easily demonstrated and widely accepted.⁵⁴

There are, of course, other anticompetitive purposes that may be achieved by tying arrangements. Tie-ins may be used to evade price controls or regulation;⁵⁵ they may also serve as a means of enforcing price discrimination through metering of consumer demand.⁵⁶ These practices, however, can be carried out only if the firm has a great deal of market power.⁵⁷ In *Data General*, as in *Jefferson Parish Hospital*,⁵⁸ there

52. 371 U.S. 38 (1962).

53. Stigler, *United States v. Loew's Inc.: A Note on Block-Booking*, 1963 SUP. CT. REV. 152, 152-53, cited in R. BORK, *supra* note 45, at 374.

54. *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 104 S. Ct. 1551, 1571 (1984) (O'Connor, J., concurring) (citation omitted) (emphasis in the original); see also Fortner I, 394 U.S. 495, 512 n.3 (1969) (White, J., dissenting) (noting limited applicability of leverage theory); Moore v. Jas. H. Matthews & Co., 550 F.2d 1207, 1212-13 (9th Cir. 1977) (recognizing that the leverage theory is questionable and concluding that the per se rule against tie-ins is invoked simply to avoid the more complex rule-of-reason analysis).

55. *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 104 S. Ct. 1551, 1567 n.47 (1984); *id.* at 1571 n.4 (O'Connor, J., concurring); Fortner I, 394 U.S. at 513 (White, J., dissenting); R. BORK, *supra* note 45, at 376; R. POSNER, *supra* note 26, at 172 n.3; Blair & Finci, *The Individual Coercion Doctrine and Tying Arrangements: An Economic Analysis*, 10 FLA. ST. U.L. REV. 531, 546-47 (1983); Hovenkamp, *supra* note 51, at 232-35.

56. *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 104 S. Ct. 1551, 1559, 1567 n.47 (1984); *id.* at 1571 n.4 (O'Connor, J., concurring); Fortner II, 429 U.S. at 617; Fortner I, 394 U.S. at 513 (White, J., dissenting); R. BORK, *supra* note 45, at 376-78; R. POSNER, *supra* note 26, at 173-74; Bowman, *supra* note 51, at 23-24; Posner, *supra* note 51, at 926; Blair & Finci, *supra* note 55, at 547-49; Hovenkamp, *supra* note 51, at 247-52.

57. Fortner II, 429 U.S. at 620; Fortner I, 394 U.S. at 514; Hovenkamp, *supra* note 51, at 237. Such use of market power could be proscribed by section 2 of the Sherman Act. See *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 104 S. Ct. 1551, 1571 (1984) (O'Connor, J., concurring).

is no evidence that the defendant engaged in price discrimination.⁵⁹

The crucial point is that both the leverage and the metering theories require some showing of market power. Under the leverage theory, the defendant must have enough power in the market for the tying product to be able to project that power into another market. Market power is also essential to the success of any price discrimination scheme.

B. *The Per Se Rule and Market Power.*

The per se rule conclusively presumes that certain activities are illegal, and thus dispenses with the need for any extensive inquiry into the reasonableness of the practice in individual cases.⁶⁰ The rule is intended to apply where a practice is "manifestly anticompetitive"⁶¹ and there is a "nearly universal view [that the practice is] subject to automatic condemnation under the Sherman Act, rather than to careful assessment under the rule of reason."⁶²

The rationale for per se rules in antitrust law suggests that a more demanding requirement of market power should be applied to tying cases than is currently in use. The court in *Jefferson Parish Hospital* noted that the rule is intended to obviate the need for detailed market inquiry in cases where anticompetitive effect is nearly certain.⁶³ In the case of tying arrangements, leverage and price discrimination are both impossible without market power.⁶⁴ A high threshold requirement of market power would enable courts to pinpoint cases where anticompetitive effect is most likely. Plaintiffs unable to meet this standard would justifiably be forced to prove that the tie-in harms competition under the rule of reason analysis.⁶⁵

In the case of tie-ins used to evade government regulations, market power is not necessary, the existence of government regulations prevents other competitors from lawfully responding to the use of the tying arrangement. See Hovenkamp, *supra* note 51, at 235.

58. *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 104 S. Ct. 1551, 1571 n.4 (1984).

59. See *Data General II*, 529 F. Supp. 801, 814-15 (N.D. Cal. 1981), *rev'd in part on other grounds*, 734 F.2d 1336 (9th Cir. 1984), *cert. denied*, 105 S. Ct. 3534 (1985). Price discrimination is nearly impossible where the quantity of tied product used is a fixed proportion of the quantity of the tying product. *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 104 S. Ct. 1551, 1567 n.47 (1984), see Hovenkamp, *supra* note 51, at 240-44 ("Fixed proportion tying arrangements generally are unlikely candidates for use as metering devices.")

60. See *supra* note 17 and accompanying text.

61. *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 50 (1977).

62. *Broadcast Music, Inc. v. CBS*, 441 U.S. 1, 16 (1979).

63. *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 104 S. Ct. 1551, 1560 n.25 (1984).

64. See *supra* notes 46-59 and accompanying text.

65. See *Jefferson Parish Hosp.*, 104 S. Ct. at 1561 ("When . . . the seller does not have either the degree or the kind of market power that enables him to force customers to purchase a second, unwanted product . . . an antitrust violation can be established only by evidence of an unreasonable restraint on competition . . .").

There is a second, and related, reason to require a strong showing of market power and thus to narrow the scope of the per se rule. A growing number of commentators have criticized the application of the per se rule in *any* tie-in case. The rule is attacked primarily because it ignores evidence of the efficiency effects of tie-ins.⁶⁶ Commentators have claimed that economic analysis simply no longer supports the harsh view of tying arrangements taken by some courts.⁶⁷ Not only are the efficiency effects of tie-ins coming to light, but the traditional leverage theory of tying arrangements is being discredited at the same time.⁶⁸

Although there is no "universal view" that tying arrangements are anticompetitive, *Jefferson Parish Hospital*⁶⁹ reaffirmed that "certain tying arrangements" are unreasonable per se.⁷⁰ The Court was strongly divided in coming to this conclusion; four concurring Justices called for the

66. See D. ARMENTANO, *supra* note 51, at 225 ("A 'rule of reason' approach to tying arrangements is certainly to be preferred to absolute illegality . . ."); R. BORK, *supra* note 45, at 365 (antitrust treats tying arrangements as "utterly pernicious, despite the increasingly obtrusive fact that it has found no adequate grounds for objecting to them at all"); R. POSNER, *supra* note 26, at 182 ("The prohibition against tie-ins ought to be radically curtailed, and in the absence of a general prohibition of systematic price discrimination eliminated."); see also *Dam, Fortner Enters. v. United States Steel: "Neither a Borrower, Nor a Lender Be,"* 1969 SUP. CT. REV. 1, 19 (per se rule fails to provide economic standards for determining when tie-ins are harmful and when they are not), cited in *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 104 S. Ct. 1551, 1563 n.33 (1984); Easterbrook, *supra* note 45, at 144-45 (the situations in which tie-ins and other vertical restraints protect monopoly are too rare to justify application of the per se rule); Comment, *Jefferson Parish Hosp. Dist. No. 2 v. Hyde: Time to Apply the Rule of Reason to Tying Arrangements*, 70 IOWA L. REV. 565, 577 (1985) (consumer welfare best served by applying rule-of-reason analysis to tie-ins).

67. See, e.g., C. HILLS, *supra* note 21, at 158 (Supp. 1983).

68. As Hills notes, the critique of the traditional leverage view involves two propositions. First, the seller of a tying product cannot induce buyers to accept the tied product without providing a discount on the price of the tying product. See *id.* at 158-59 (citing *Fortner I*, 394 U.S. 495, 513 (1969) (White, J., dissenting)). Moreover, "in the absence of price discrimination, a monopolist of one product [market] cannot increase profits by tying a complementary (vertically related) product to the product over which the monopoly is held." C. HILLS, *supra* note 21, at 159 (Supp. 1983); see *supra* notes 51-59.

69. 104 S. Ct. 1551 (1984).

70. *Id.* at 1556. The Court's response focused upon precedent: "It is far too late in the history of our antitrust jurisprudence to question the proposition that certain tying arrangements . . . are unreasonable 'per se.'" *Id.* Although the importance of precedent cannot be doubted, the majority opinion in *Jefferson Parish Hosp.* brings to mind the words of Karl Llewellyn:

[C]ategories and concepts, once formulated and once they have entered into thought processes, tend to take on an appearance of solidity, reality and inherent value which has no foundation in experience. More than this: although originally formulated on the model of at least some observed data, they tend, once they have entered into the organization of thinking, both to suggest the presence of corresponding data when these data are not in fact present, and to twist any fresh observation of data into conformity with the terms of the categories. . . . It is peculiarly troublesome in regard to legal concepts, because of the tendency of the crystallized legal concept to persist after the fact model from which the concept was once derived has disappeared or changed out of recognition.

Llewellyn, *A Realistic Jurisprudence—The Next Step*, 30 COLUM. L. REV. 431, 453-54 (1930).

abandonment of the per se rule.⁷¹ The majority opinion in *Jefferson Parish Hospital* does not, however, preclude the requirement of a strong showing of market power.⁷² The Court noted that market power "in some abstract sense" will not suffice;⁷³ market power in the economic sense—control over price—must be proved.⁷⁴

Given the strong economic arguments against the per se rule, the best course would be to apply the rule only in cases where anticompetitive effects seem very likely. This narrow interpretation is supported by *Continental T.V., Inc. v. GTE Sylvania Inc.*,⁷⁵ in which the Supreme Court overturned the per se rule against territorial restrictions on franchises. Criticizing "formalistic line drawing," the Court focused on the need to show "demonstrable economic effect" in cases involving vertical restraints.⁷⁶ The elements of the per se rule are somewhat flexible;⁷⁷ by adopting a more demanding standard for market power, courts can retain the benefits of the per se rule while applying it only in cases of truly anticompetitive behavior.

C. Proof of Economic Power in Per Se Tying Cases.

In order for a tying arrangement to be illegal per se, the seller must have sufficient economic power in the tying product market to restrain

71. *Jefferson Parish Hosp.*, 104 S. Ct. at 1570-74 (O'Connor, J., concurring). Justice O'Connor was joined in her opinion by Chief Justice Burger, and by Justices Powell and Rehnquist. *Id.* at 1569. Judge Feinberg has written, for example:

The tie-in field, like much of antitrust law, rests on economic assumptions that are coming under increased scrutiny. I concur in the changed result reached by the new majority because I agree that in view of the present case law and the current learning, it would be unjustifiable to extend the law regarding tying to the fact pattern present here.

Shop & Save Food Mkts., Inc. v. Pneumo Corp., 683 F.2d 27, 31 (2d Cir. 1982) (Feinberg, J., concurring) (citation omitted), cert. denied, 459 U.S. 1038 (1983). In that case, the United States Court of Appeals for the Second Circuit decided on rehearing that the per se rule against tie-ins should not apply where a "penalty" rent was charged by the defendant when the plaintiff refused to purchase groceries from it. *Id.* at 30-31. The court found that anticompetitive forcing could not be shown because the plaintiff refused to purchase the groceries—though it did pay the higher rental charge. *Id.*

72. See *Jefferson Parish Hosp.*, 104 S. Ct. at 1560-67 (discussing various prerequisites for the application of the per se rule).

73. *Id.* at 1566.

74. *Id.* at 1566 n.46.

75. 433 U.S. 36 (1977).

76. *Id.* at 58-59.

77. See *infra* notes 119 & 177 and accompanying text (rejecting mechanical legal rules in favor of market analysis); see also *United States v. Jerrold Elecs. Corp.*, 187 F. Supp. 545, 555-56 (E.D. Pa. 1960) (discussing the discretion available in determining whether per se rule is applicable), *aff'd per curiam*, 365 U.S. 567 (1961); R. GIVENS, *supra* note 21, at xvii (discussing the need in antitrust law for consideration of changing economic circumstances); R. POSNER, *supra* note 26, at 182-83 (calling for limitations on liability for tying arrangements); Easterbrook, *Is There a Ratchet in Antitrust Law?* 60 TEX. L. REV. 705, 706-10 (1982) (arguing that antitrust rules should be flexible).

competition in the market for the tied product.⁷⁸ In *Data General*, the Ninth Circuit correctly indicated that tying cases do not require the detailed market power analysis that is necessary, for example, in a monopolization case.⁷⁹ However, the court failed to recognize that the Supreme Court has nonetheless required a strong showing of market power. *Jefferson Parish Hospital*, for instance, held that a showing of both thirty percent market share and imperfect consumer information "do[es] not generate the kind of market power that justifies condemnation of tying."⁸⁰ In *Fortner Enterprises v. United States Steel Corp. (Fortner I)*,⁸¹ the Supreme Court indicated that "the proper focus of concern is whether the seller has the power to raise prices, or impose burdensome terms such as a tie-in, with respect to any appreciable number of buyers within the market."⁸² This statement has not been read to imply that the mere existence of a tying arrangement is sufficient to prove market power. Rather, *Fortner I* and *Jefferson Parish Hospital* require proof of control over price or other terms,⁸³ not "'market power' in some abstract sense."⁸⁴

Evidence of this market power can include proof of dominance in the tying product market or proof that the seller's product is sufficiently unique to confer "some advantage not shared by [its] competitors in the

78. See *supra* note 23 and accompanying text.

79. *Digidyne Corp. v. Data General Corp.*, 734 F.2d 1336, 1339 (9th Cir. 1984), cert. denied, 105 S. Ct. 3534 (1985); see *United States v. Loew's Inc.*, 371 U.S. 38, 45 n.4 (1962) (in tie-in case, government need not "demonstrat[e] . . . market power in the sense of § 2 of the Sherman Act").

80. *Jefferson Parish Hosp.*, 104 S. Ct. at 1566.

The recently issued Department of Justice guidelines for tying arrangements and other vertical restraints provide some assistance in defining the requisite market power. See Department of Justice Vertical Restraints Guidelines, 50 Fed. Reg. 6263 (1985). The Guidelines indicate that the Department of Justice will not challenge a tying arrangement if the party imposing the arrangement possesses a market share of 30% or less, unless the tie-in unreasonably restrains competition under the rule of reason. *Id.* at 6272. If the market share in the tying product market is greater than 30%, the Department of Justice "will attempt to determine whether the seller has 'dominant' market power." *Id.* If dominance is found and the other elements of the per se rule are present, the Guidelines view the tie-in as illegal per se. If dominant power is not found, however, then the Department of Justice will again apply the rule of reason. *Id.* In the last situation, the seller's substantial market power will be considered in the analysis, but will not justify per se condemnation. Thus the Vertical Restraints Guidelines appear to track *Jefferson Parish Hosp.* in its market power analysis. Although the Guidelines are not binding on private litigants or the courts, they do serve as indicators of the government's enforcement policy. They also reflect a sound view of the circumstances where condemnation of tying arrangements is justified.

81. 394 U.S. 495 (1969).

82. *Id.* at 504; see *Fortner II*, 429 U.S. 610, 620 (1976).

83. See *Jefferson Parish Hosp.*, 104 S. Ct. at 1565 ("The fact that [customers] are required to purchase two separate items is only the beginning of the appropriate inquiry."); *Fortner II*, 429 U.S. at 620 n.13 (read in context, *Fortner I* requires control over price) (citing *Dam*, *supra* note 66, at 25-26).

84. *Jefferson Parish Hosp.*, 104 S. Ct. at 1566.

market for the tying product."⁸⁵ Economic power can also be shown where a substantial number of buyers have accepted the package, but only when this fact can be explained solely by the seller's market power.⁸⁶

In *Data General*, there was no claim that the defendant in fact dominated its market. The Ninth Circuit found instead that RDOS was sufficiently unique to confer the required market power on *Data General*.⁸⁷ The court based its conclusion on several factors: (1) the distinctiveness and desirability of RDOS, (2) the copyright on RDOS, and (3) the existence of a "lock-in."⁸⁸ The court's lock-in argument⁸⁹ is circular because it assumes the uniqueness of *Data General*'s software. If there are compatible alternatives, then *Data General*'s customers will not be locked into purchasing its software.⁹⁰ Moreover, two other courts have rejected similar lock-in arguments.⁹¹

The *Data General* court found the uniqueness requirement fulfilled by evidence that RDOS was "particularly desirable to a substantial number of buyers."⁹² This desirability is insufficient to show market power unless it gives the seller economic power: the power to raise prices by restricting output.⁹³ *United States Steel Corp. v. Fortner Enterprises (Fortner II)*⁹⁴ quotes a commentator who interprets this test to require the following proof: "Whenever there are some buyers who find a seller's product uniquely attractive, and are therefore willing to pay a premium

85. *Fortner II*, 429 U.S. at 620; see also *United States v. Loew's Inc.*, 371 U.S. 38, 45 (1962) ("Even absent a showing of market dominance, the crucial economic power may be inferred from the tying product's desirability . . . or uniqueness . . .").

86. *Fortner II*, 429 U.S. at 618 n.10; *Moore v. Jas. H. Matthews & Co.*, 550 F.2d 1207, 1216 (9th Cir. 1977). One court has noted that it is circular reasoning to assume market power from the existence of a tie-in accepted by a significant number of buyers. *Ungar v. Dunkin' Donuts, Inc.*, 531 F.2d 1211, 1224-25 (3d Cir.), cert. denied, 429 U.S. 823 (1976).

87. *Digidyne Corp. v. Data General Corp.*, 734 F.2d 1336, 1341-43 (9th Cir. 1984), cert. denied, 105 S. Ct. 3534 (1985).

88. *Id.*

89. See *supra* notes 37-38 and accompanying text for a discussion of the alleged lock-in.

90. It is quite possible that compatible alternatives exist. See, e.g., Enright, *Preview: The Kaypro 16*, PROFILES, Feb. 1985, at 74, 74, 76 (noting ability of competing manufacturers to "clone" IBM personal computer and operating system software without violating patent and copyright laws). In addition, the lock-in could be avoided by conversion to a similar system. *Data General II*, 529 F. Supp. 801, 814 (N.D. Cal. 1981), rev'd in part, 734 F.2d 1336 (9th Cir. 1984), cert. denied, 105 S. Ct. 3534 (1985).

91. One of these cases involved another challenge to *Data General*'s marketing practices. *Warner Management Consultants, Inc. v. Data General Corp.*, 545 F. Supp. 956, 965-66 (N.D. Ill. 1982) (rejecting lock-in as evidence of market power). The other case involved Kodak's alleged "technological tie" of film and cameras. *Berkey Photo, Inc. v. Eastman Kodak Co.*, 603 F.2d 263, 285-86 (2d Cir. 1979) (monopolization case), cert. denied, 444 U.S. 1093 (1980).

92. *Data General*, 734 F.2d at 1341.

93. *Jefferson Parish Hosp.*, 104 S. Ct. at 1566 & n.46; *Fortner I*, 394 U.S. 495, 503-04 (1969).

94. 429 U.S. 610 (1977).

above the price of its nearest substitute, the seller has the opportunity to impose a tie"⁹⁵ In *Fortner I* and *Fortner II*, for example, the alleged tie-in involved extremely favorable credit terms tied to the purchase of prefabricated housing.⁹⁶ The Supreme Court reversed a finding that the purportedly advantageous financing terms were sufficiently unique or desirable to confer market power.⁹⁷ The Court did not view the fact that the financing terms were "unique and unusual" as dispositive of the market power issue.⁹⁸

In *Data General*, there was no showing of the economic power required under the *Fortner II* standard. The trial court described the market as highly competitive, and it found no evidence of noncompetitive pricing or price discrimination.⁹⁹ Moreover, the existence of a large number of purchasers for Data General's package can be explained by the competitiveness of the package¹⁰⁰ or by the efficiency of bundling the hardware and software.¹⁰¹

Evidence of economic power, or power over price, in the tying product market is an essential element of the per se rule against tie-ins. As noted in *Jefferson Parish Hospital*, once sufficient market power is proved, the probability increases that the tie-in has anticompetitive effects.¹⁰² Thus, application of an economic test—rather than mechanical rules—ensures that the harsh per se rule will be used only in cases where its assumptions are justified.

D. *The Presumption of Market Power Arising from Copyrights.*

A major basis for imposing liability on Data General was the presumption of uniqueness, and thus market power, arising from Data General's copyright on its software, RDOS.¹⁰³ Despite its acknowledgement that a copyright merely creates a rebuttable presumption of economic

95. *Id.* at 621 n.14 (quoting Note, *The Logic of Foreclosure: Tie-In Doctrine After Fortner v. U.S. Steel*, 79 YALE L.J. 86, 93-94 (1969)).

96. *Id.* at 611; *Fortner I*, 394 U.S. 495, 496-97 (1969).

97. *Fortner II*, 429 U.S. at 620-21. The evidence of uniqueness rejected in *Fortner II* included the following: the defendant was owned by one of the largest industrial corporations in the country; a large number of customers purchased the package; U.S. Steel charged a "noncompetitive price" for its homes; and the finance terms were unusual (including 100% financing). *Id.* at 614.

98. *Id.* at 621 (citing *Fortner I*, 394 U.S. at 505).

99. *Data General II*, 529 F. Supp. 801, 813-15 (N.D. Cal. 1981), *rev'd in part*, 734 F.2d 1336 (9th Cir. 1984), *cert. denied*, 105 S. Ct. 3534 (1985).

100. *Id.* at 815-16.

101. This point refers to the business justifications discussed *infra* notes 134-84 and accompanying text.

102. *Jefferson Parish Hosp.*, 104 S. Ct. at 1560-61.

103. *Digidyne Corp. v. Data General Corp.*, 734 F.2d 1336, 1341 (9th Cir. 1984), *cert. denied*, 105 S. Ct. 3534 (1985); *see also* *United States v. Loew's Inc.*, 371 U.S. 38, 45-46 (1962) (discussing presumption of market power arising from copyrights and patents).

power,¹⁰⁴ the Ninth Circuit effectively treated the existence of the copyright as conclusive evidence of market power. Specifically, the court stated that the copyright made RDOS "unique as a matter of law,"¹⁰⁵ and it was apparently unwilling to consider Data General's rebuttal on the point.¹⁰⁶ In contrast, the trial court had noted the highly competitive nature of the computer market, the existence of more than one hundred competing brands of software, the clear availability of substitutes for RDOS, and the complete lack of evidence that Data General had control over price.¹⁰⁷ It is difficult to conceive of more persuasive evidence that Data General did not have market power. Indeed, under the Ninth Circuit's view of the issue, it is difficult to see how even the smallest computer manufacturer in the country could prove that its copyright did not give rise to market power.¹⁰⁸

The *Data General* court's unfortunate reliance on the presumption of market power arising from copyright can be traced to the confusing origin and nature of that presumption. An early patent case, *Motion Picture Patents Co. v. Universal Film Manufacturing Co.*,¹⁰⁹ involved a tie-in of patented movie projectors and films. The Court in that case applied the doctrine of patent misuse, which penalizes a patentee's attempts to extend the patent monopoly by requiring it to forfeit its patent rights.¹¹⁰ The early patent and copyright tie-in cases cited and were influenced by this doctrine.¹¹¹

104. *Data General*, 734 F.2d at 1344 ("The burden to rebut the presumption shifted to defendant.").

105. *Id.* at 1342-43.

106. *Id.* at 1345-46.

107. *Data General II*, 529 F. Supp. 801, 813-16 (N.D. Cal. 1981), *rev'd in part*, 734 F.2d 1336 (9th Cir. 1984), *cert. denied*, 105 S. Ct. 3534 (1985).

108. Liability would be limited only by the requirement that a "not insubstantial" amount of commerce be affected. This requirement is easily met. See *supra* note 28.

109. 243 U.S. 502 (1917).

110. See *id.* at 516-19. For example, the Supreme Court in 1942 applied the principles of equity to bar a patent infringement suit where the patent holder engaged in tying. *Morton Salt Co. v. G.S. Suppiger Co.*, 314 U.S. 488, 492-94 (1942).

111. See *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 104 S. Ct. 1551, 1572 n.7 (1984) (O'Connor, J., concurring):

Although *United States v. Paramount Pictures, Inc.* considered the legality of "block booking" of motion pictures, which ties the purchase of rights to copyrighted motion pictures to purchase of other motion pictures of the same copyright holder, the Court did not analyze the arrangement with the schema of the tying cases. Rather, the Court borrowed the patent law principle of "patent misuse," which prevents the holder of a patent from using the patent to require his customers to purchase unpatented products.

Id. (citation omitted). In *United States v. Paramount Pictures, Inc.*, 334 U.S. 131 (1948), the Supreme Court condemned block booking because the practice prevented competition on the merits and allegedly extended the seller's copyright monopoly to other products. *Id.* at 156-57. "That enlargement of the monopoly of the copyright was condemned below in reliance on the principle which forbids the owner of a patent to condition its use on the purchase or use of patented or unpatented materials." *Id.* at 157. To support these propositions, the Court included citations to

The extension of this patent law doctrine into antitrust is troubling because it exposes a patent holder to liability for *both* treble damage penalties and patent law sanctions. In addition, the early copyright-antitrust cases, *United States v. Loew's Inc.*¹¹² and *United States v. Paramount Pictures, Inc.*,¹¹³ involved motion pictures that were "unique" and "non-replicable."¹¹⁴ The copyrighted motion picture *Gone With the Wind* can readily be described as unique, but a copyrighted computer operating system is not unique in the same sense. Consumers are not concerned with insignificant differences between RDOS and other operating systems. Two copyrighted software programs that are functionally equivalent will be indistinguishable to the average consumer, whereas two movies, even with similar plot lines, will not.¹¹⁵

The Court in *Loew's* recognized the possibility that some tying arrangements involving copyrighted or patented products would not violate the antitrust laws.¹¹⁶ In *Data General*, the Ninth Circuit did not dispute the trial court's holding that the presumption arising from copyrights is rebuttable.¹¹⁷ However, the court placed so much emphasis on the existence of the copyright that the presumption was effectively rendered conclusive. Indeed, the court seemed unwilling to consider the

two patent misuse cases: *Morton Salt Co. v. G.S. Suppiger Co.*, 314 U.S. 488 (1942), and *Mercoid Corp. v. Mid-Continent Investment Co.*, 320 U.S. 661 (1944). See *Paramount Pictures*, 334 U.S. at 157; see also *United States v. Loew's Inc.*, 371 U.S. 38, 45-56 (1962) (noting that the presumption of market power arose in the patent misuse cases); R. BORK, *supra* note 45, at 366 (early cases were "decided under law of patent misuse"); W. BOWMAN, *supra* note 51, at 153-54, 157-58, 182 (discussing the influence of patent misuse and leverage notions on the law of tie-ins); R. POSNER, *supra* note 26, at 172 (same); E. SINGER, *ANTITRUST ECONOMICS AND LEGAL ANALYSIS* 112-13 (1981) (same).

112. 371 U.S. 38 (1962).

113. 334 U.S. 131 (1948).

114. W. HOLMES, *supra* note 21, § 36.05, at 17; see *Loew's*, 371 U.S. at 48 (holding that the presumption of films' uniqueness arising from copyright was confirmed by the lower court's proper findings regarding nature of the films); *Paramount Pictures*, 334 U.S. at 156-59 (applying "patent tying" cases to block-booking practices of motion picture distributors).

115. Professor Samuelson has noted that computer programs are viewed by most users as a "black box." See Samuelson, *supra* note 42, at 681-82 ("The user does not care how the program does what it does, just that it does what it is supposed to do.").

116. See *Loew's*, 371 U.S. at 49-50 ("There may be rare circumstances in which the doctrine . . . prohibiting tying arrangements involving patented or copyrighted tying products is inapplicable."); see also W. HOLMES, *supra* note 21, § 36.05, at 15 (discussing *Loew's*).

117. *Data General*, 734 F.2d at 1344. See also *Data General II*, 529 F. Supp. 801, 816 (N.D. Cal. 1981) ("[T]he existence of copyright notices generally creates a presumption of economic power but does not conclusively presume such power."), *rev'd in part on other grounds*, 734 F.2d 1336 (9th Cir. 1984), *cert. denied*, 105 S. Ct. 3534 (1985); *Data General I*, 490 F. Supp. at 1113. Oddly, the court of appeals asserted that the trial judge erred by placing the burden of proving economic power on the plaintiffs. *Data General*, 734 F.2d at 1344. In fact, the trial judge instructed the jury that the presumption arising from the copyright shifted the burden of proof to the defendant. *Data General II*, 529 F. Supp. at 811.

substantial evidence offered to rebut the presumption of market power.¹¹⁸ The Ninth Circuit's approach is inconsistent with *Jefferson Parish Hospital* and other Supreme Court decisions that indicate the need for a factual showing of market power and criticize the use of mechanical legal rules to decide complex economic questions.¹¹⁹ Given the importance of market power as a theoretical, legal, and economic prerequisite to liability for tying arrangements,¹²⁰ it seems unreasonable to eliminate economic power as an issue simply because the tying product is copyrighted.

The presumption of market power arising from copyrights and patents has come under increasing criticism in recent years, both from commentators¹²¹ and from the Supreme Court. Justice O'Connor, in a concurring opinion joined by three other members of the Court, voiced such a concern in *Jefferson Parish Hospital*:

A common misconception has been that a patent or copyright . . . suffice[s] to demonstrate market power. While [this fact] might help to give market power to a seller, it is also possible that a seller in these situations will have no market power: for example, a patent holder has no market power in any relevant sense if there are close substitutes for the patented product.¹²²

118. See *supra* notes 87-101 and accompanying text.

119. *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 104 S. Ct. 1551, 1559, 1566 (1984); *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 50-51 (1977) (quoting *White Motor Co. v. United States*, 372 U.S. 253, 263 (1963)); *Fortner II*, 429 U.S. 610, 620-22 (1977); *Fortner I*, 394 U.S. 495, 503-05 (1969).

120. See *supra* notes 46-86 and accompanying text.

121. As Professor, now Judge, Richard Posner notes:

A patent is actually a poor proxy for monopoly power, since most patents confer too little monopoly power to be a proper object of antitrust concern. Some patents confer no monopoly power at all. A patent may simply enable a firm to reduce the cost advantage of a competing firm; in such a case the patent might actually reduce the amount of monopoly power in the market. Its popularity in the tie-in cases may stem from the fact that the earliest such cases were not antitrust cases at all. They were patent-misuse cases, where the issue was whether the patentee had improperly extended the patent monopoly by monopolizing an unpatented product tied to the patented product.

R. POSNER, *supra* note 26, at 172 n.3 (citations and parentheses omitted). "Implicit in the presumption [of market power] is the belief that since a patent or copyright is a statutory monopoly, it follows that each must also be a market monopoly. But all patents do not confer substantial or even significant market power." E. SINGER, *supra* note 111, at 112; see also D. ARMENTANO, *supra* note 51, at 203-05 (criticizing presumption of market power in context of *International Salt*); THE ATTORNEY GENERAL'S NATIONAL COMMITTEE TO STUDY THE ANTITRUST LAWS 238 (1955) ("The Committee feels [that] . . . the fact that the tying product is patented need not be decisive of illegality."); R. BORK, *supra* note 45, at 367-68 (criticizing presumption of market power). See generally W. BOWMAN, *supra* note 51, at 53 (noting that patent does not necessarily confer market power).

The presumption of market power is also a manifestation of the discredited leverage theory. See E. SINGER, *supra* note 111, at 112 (patent monopoly is not necessarily extended by tie-in); see also note 51 (discussion of leverage theory).

122. *Jefferson Parish Hosp.*, 104 S. Ct. at 1572 n.7. See generally Landes & Posner, *Market Power in Antitrust Cases*, 94 HARV. L. REV. 937 (1981).

In addition, it is likely that patents confer greater market power than do copyrights. An invention is required to have some degree of "novelty" in order to secure patent protection.¹²³ A copyrighted work, on the other hand, need not meet the novelty standard.¹²⁴ Moreover, copyrighted material can be duplicated as long as it is not copied; a patented device cannot be duplicated at all.¹²⁵ Copyright protects only the "expression" of a computer program, not the basic idea behind the program.¹²⁶ The copyright monopoly thus does not prevent others from appropriating the idea embodied in that program. Finally, copyright infringers are protected by the fair use doctrine, which is not available to patent infringers.¹²⁷ "Fair use" is a privilege permitting limited and reasonable use of copyrighted material.¹²⁸ Thus it can be argued that the presumption of market power arising from a copyright should be weaker than the presumption arising in patent cases.

Courts have drawn a similar distinction with regard to trademarks.

123. 35 U.S.C. § 102 (1982), see *Loew's*, 371 U.S. at 46 (because goal of patent laws is to reward uniqueness, existence of patent can be used to infer uniqueness in tying cases).

124. In order to secure a statutory copyright, the author need only "originate" the work and fix it in a tangible medium. 17 U.S.C. § 102(a) (1982).

125. See 17 U.S.C. § 102(b) (1982) (idea/expression distinction in copyright); C. McMANIS, *THE LAW OF UNFAIR TRADE PRACTICES* 239 (1982) (if two authors produce identical works independently, i.e., without copying the work of the other, then each author may copyright his work); see also 17 U.S.C. § 405(b) (1982) (no liability for innocent infringer when copyright notice has been omitted and infringer has not received actual notice that the material has been registered); 17 U.S.C. § 504(c)(2) (1982) (exemption from statutory damages for innocent infringement by non-profit educational institutions or public broadcasters). Judge Hand explained the patent/copyright distinction as follows:

To sustain [a finding of copyright infringement] . . . more must appear than the mere similarity, or even identity, of the supposed infringement with the part in question. In this lies one distinction between a patent and a copyright. One may infringe a patent by the innocent reproduction of the machine patented, but the law imposes no prohibition upon those who, without copying, independently arrive at the precise combination of words or notes which have been copyrighted.

Fred Fisher, Inc. v. Dillingham, 298 F. 145, 147 (S.D.N.Y. 1924). Judge Hand developed this same principle, twelve years later, into his memorable fantasy of the recreation of Keats's "Ode on a Grecian Urn": "[I]f by some magic a man who had never known it were to compose anew Keats's Ode on a Grecian Urn, he would be an 'author,' and, if he copyrighted it, others might not copy that poem, though they might of course copy Keats's." *Sheldon v. Metro-Goldwyn Pictures Corp.*, 81 F.2d 49, 54 (2d Cir.) (citations omitted), *cert. denied*, 298 U.S. 669 (1936).

126. See Samuelson, *supra* note 42, at 754-55.

127. 17 U.S.C. § 107 (1982) (copyright fair use provision).

128. "Fair use" has been defined as a privilege permitting the reasonable and justifiable use of copyrighted material without the consent of the copyright holder. *Rosemont Enters. v. Random House, Inc.*, 366 F.2d 303, 306 (2d Cir. 1966), *cert. denied*, 385 U.S. 1009 (1967). Section 107 of the Copyright Act of 1976 mandates that four factors be considered in determining whether a use is fair: the purpose and character of the use, the nature of the copyrighted work, the amount and substantiality of the taking, and the effect of the use on the market for the copyrighted work. 17 U.S.C. § 107 (1982).

In *Carpa, Inc. v. Ward Foods, Inc.*,¹²⁹ the United States Court of Appeals for the Fifth Circuit held that trademarks are only persuasive evidence of market power. The United States Court of Appeals for the Second Circuit has concluded that trademarks merely serve to identify the franchisor, and that proof of actual economic power is therefore still required.¹³⁰ Other courts have recognized that the mere presence of a trademark does not prove actual economic power, and have therefore rejected any presumption of market power flowing from the presence of a trademark.¹³¹ In contrast, the Ninth Circuit has held that a trademark creates the same presumption of market power as does a patent or a copyright.¹³² The approach of the Second and Fifth Circuits is sounder because it recognizes that a legal right does not necessarily confer economic power. This pragmatic analysis should be applied in copyright cases.

There is no precedent establishing that copyrights create an irrebuttable presumption of market power.¹³³ A product that meets the statutory requirements for copyrightability may not possess the qualities necessary to create a market success. Given the important role of market power in finding antitrust violations, a copyright should at most give rise to a rebuttable presumption. Indeed, it can be argued that the copyright should merely be persuasive evidence of economic power. In any case, the defendant should be allowed to prove that it does not have the ability to raise prices or impose other burdensome terms on its customers.

IV. "REDEEMING VIRTUES": BUSINESS JUSTIFICATIONS FOR TIE-INS

Although labeled a "per se" violation of the antitrust laws, tying arrangements have generally not been deemed illegal without some con-

129. 536 F.2d 39, 48 (5th Cir. 1976).

130. *Capital Temporaries, Inc. v. Olsten Corp.*, 506 F.2d 658, 663-65 (2d Cir. 1974); *Susser v. Carvel Corp.*, 332 F.2d 505, 519-21 (2d Cir. 1964), *cert. dismissed*, 381 U.S. 125 (1965).

131. See *United States v. Mercedes-Benz of N. Am., Inc.*, 517 F. Supp. 1369, 1386-87 (N.D. Cal. 1981) (holding that although the Ninth Circuit allows a presumption in some circumstances, trademark alone is not sufficient to prove market leverage); *Q. T. Mkts., Inc. v. Fleming Cos.*, 394 F. Supp. 1102, 1109 (D. Colo. 1975) (where plaintiff cannot show any factor in addition to mere existence of trademark, no presumption of coercive market power is justified); *Golden West Insulation, Inc. v. Stardust Investment Corp.*, 47 Or. App. 493, 501-04, 615 P.2d 1048, 1053-54 (1980) (applying Oregon antitrust law) (a trademark "alone cannot create a presumption of sufficient economic power over the market for the tying product"); see also *Redd v. Shell Oil Co.*, 524 F.2d 1054, 1057 (10th Cir. 1975) (rejecting application of per se rule on grounds that a trademark is not a separate product for purposes of two product requirement), *cert. denied*, 425 U.S. 912 (1976).

132. *Siegel v. Chicken Delight, Inc.*, 448 F.2d 43, 50 (9th Cir. 1971) (registered trademark presents legal barrier against competition), *cert. denied*, 405 U.S. 955 (1972).

133. See *Data General I*, 490 F. Supp. 1089, 1112 (N.D. Cal. 1980) ("[T]he sole fact of the existence of a copyright notice has not been held to be sufficient to prove economic power."); *aff'd in relevant part*, 734 F.2d 1336 (9th Cir. 1984), *cert. denied*, 105 S. Ct. 3534 (1985).

sideration of business justifications.¹³⁴ Despite the often cited assertion that "tying arrangements serve hardly any purpose beyond the suppression of competition,"¹³⁵ tie-ins may have a number of beneficial effects. First, a tie-in may be used to facilitate the introduction of a new product.¹³⁶ Second, it can be used to evade price monitoring by cartels.¹³⁷ Three other possible purposes are the protection of goodwill,¹³⁸ the capture of economies of joint production and distribution,¹³⁹ and the elimination of the free rider problem.¹⁴⁰ Defenses based upon the goodwill, efficiency, and free rider theories were rejected at an early stage in the *Data General* litigation.¹⁴¹ The trial court rejected those justifications because such defenses are available only in limited circumstances and are accepted only when there are no "less restrictive alternatives" to the tying arrangement.¹⁴²

134. See *supra* notes 21-24 and accompanying text.

135. *Standard Oil Co. v. United States*, 337 U.S. 293, 305-06 (1949), quoted in *Northern Pac. Ry. v. United States*, 356 U.S. 1, 6 (1958).

136. The most famous case discussing the "new industry" defense is *United States v. Jerrold Elec. Corp.*, 187 F. Supp. 545, 555-60 (E.D. Pa. 1960) (tie-in is reasonable when used to facilitate development of new line of business), *aff'd per curiam*, 365 U.S. 567 (1961). See *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 55 (1977) (discussing use of tie-ins to facilitate development of emerging markets or new technologies); *Northern v. McGraw-Edison Co.*, 542 F.2d 1336, 1347 (8th Cir. 1976) (same), *cert. denied sub nom. McGraw-Edison Co. v. Soper*, 429 U.S. 1097 (1977); *Carpa, Inc. v. Ward Foods, Inc.*, 536 F.2d 39, 47 (5th Cir. 1976) (same); ABA ANTITRUST SECTION, *supra* note 21, at 89-90 (discussing the new product defense); ABA ANTITRUST SECTION, MONOGRAPH NO. 8, VERTICAL RESTRICTIONS UPON BUYERS LIMITING PURCHASES OF GOODS FROM OTHERS 12, 20-21 (1982) (same) [hereinafter cited as ABA MONOGRAPH]; C. HILLS, *supra* note 21, at 108-09 (same); W. HOLMES, *supra* note 21, § 34.03 (same); Note, *Newcomer Defenses: Reasonable Use of Tie-ins, Franchises, Territorials and Exclusives*, 18 STAN. L. REV. 457, 458-65 (1966) (same). Similarly, a tying arrangement might aid a new entrant in an established market, "[t]ie-ins . . . may facilitate new entry into fields where established sellers have wedded their customers to them by ties of habit and custom." *Fortner I*, 394 U.S. 495, 514 n.9 (1969) (White, J., dissenting), quoted in *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 104 S. Ct. 1551, 1573 (1984) (O'Connor, J., concurring); see *GTE Sylvania*, 433 U.S. at 55 (discussing use of tie-in by new manufacturer); *White Motor Co. v. United States*, 372 U.S. 253, 263 (1963) (same); *Brown Shoe Co. v. United States*, 370 U.S. 294, 330 (1962) (same); Easterbrook, *supra* note 45, at 149-50 (discussing increase in product variety resulting from entry of firm using vertical restraint) (citing Douglas & Miller, *Quality Competition, Industry Equilibrium, and Efficiency in the Price-Constrained Airline Market*, 64 AM. ECON. REV. 657, 668 (1974) and Scherer, *The Economics of Vertical Restraints*, 52 ANTITRUST L.J. 687, 704 (1983)).

137. See *Fortner I*, 394 U.S. 495, 514 n.9 (1969) (White, J., dissenting) (tie-in "may permit clandestine price cutting" thus lessening threat of retaliation by cartel), cited in *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 104 S. Ct. 1551, 1573-74 (1984) (O'Connor, J., concurring); Easterbrook, *supra* note 45, at 146 (tie-in may enable firm to cheat in cartelized market).

138. See *infra* notes 153-77 and accompanying text.

139. See *infra* notes 178-84 and accompanying text.

140. See *infra* note 181.

141. *Data General I*, 490 F. Supp. 1089, 1120-1124 (N.D. Cal. 1980), *aff'd in relevant part*, 734 F.2d 1336 (9th Cir. 1984), *cert. denied*, 105 S. Ct. 3534 (1985).

142. *Id.* at 1120 (quoting *Siegel v. Chicken Delight, Inc.*, 448 F.2d 43, 51 (9th Cir. 1971), *cert. denied*, 405 U.S. 955 (1972)); see also *Moore v. Jas. H. Matthews & Co.*, 550 F.2d 1207, 1217 (9th Cir. 1977) (justifications for tie-ins available only in limited circumstances).

The trial court's view of business justifications seems to conflict with the rationale of the Supreme Court's decision in *GTE Sylvania*.¹⁴³ Overturning the per se rule against territorial restrictions on franchises, the Court in that case focused upon the "redeeming virtues" of vertical restrictions.¹⁴⁴ The redeeming virtues discussed in *GTE Sylvania*—facilitation of new businesses, protection of goodwill, efficient marketing, and the elimination of the free rider problem¹⁴⁵—are as relevant to tying cases as they are to territorial restrictions. As the Supreme Court indicated in *Monsanto Co. v. Spray-Rite Service Corp.*,¹⁴⁶ "the economic effect of . . . unilateral and concerted vertical price-setting, agreements on price and non-price restrictions . . . is in many, but not all, cases similar or identical."¹⁴⁷ Justice White, in his concurrence in *GTE Sylvania*, noted that the distinction between price and non-price vertical restraints "may be as difficult to justify as that [made by] *Schwinn*."¹⁴⁸

Tying law can therefore be reconciled with *GTE Sylvania* in two ways. First, the per se rule against tying arrangements can be eliminated.¹⁴⁹ Alternatively, courts can give greater attention to business justifications under the partial per se rule.¹⁵⁰ Although the former approach was rejected in *Jefferson Parish Hospital*,¹⁵¹ the Supreme Court did not address the argument that business justifications should be construed more broadly.¹⁵² This section reviews two business justifications that may be applicable to the *Data General* case in light of *GTE Sylvania* and *Jefferson Parish Hospital*.

A. The Goodwill Defense.

The goodwill defense rests upon the fact that a manufacturer's product might not function properly when used in conjunction with a component manufactured by another firm. The other firm's component may be defective or simply incompatible. Manufacturers of complex devices thus have an incentive to sell two complementary products as a package in order to avoid consumer dissatisfaction. By using a tie-in, the manu-

143. *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977).

144. *Id.* at 54.

145. *Id.* at 54-55.

146. 465 U.S. 752 (1984).

147. *Id.* at 762; see C. Hillis, *supra* note 21, at 159-61 (Supp. 1983) (discussing relevance of *GTE Sylvania* to tying arrangement law).

148. *GTE Sylvania*, 433 U.S. at 70 (White, J., concurring).

149. See *supra* notes 66-71 and accompanying text.

150. See *supra* notes 21-24 and accompanying text for a discussion of the partial per se rule.

151. See *supra* note 70 and accompanying text.

152. See *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 104 S. Ct. 1551, 1564 n.39, 1565 n.42 (1984).

facturer is able to maintain its goodwill and reputation.¹⁵³ For example, in *Pick Manufacturing Co. v. General Motors Corp.*,¹⁵⁴ the United States Court of Appeals for the Seventh Circuit upheld GM's requirement that its dealers sell and install only genuine GM parts. The arrangement was viewed as an attempt to avoid harm to GM's goodwill.¹⁵⁵ A tie-in of a patented silo unloader and patented silos was upheld in *Dehydrating Process Co. v. A. O. Smith Corp.*¹⁵⁶ In that case the tying arrangement was instituted after customers complained of malfunctions when other silos were used.¹⁵⁷ The Supreme Court has also noted that federal and state laws impose safety and quality requirements on firms, giving them another reason to maintain quality standards.¹⁵⁸

Defendants who raise the goodwill justification must show that there are no less restrictive alternatives available. In other words, the tie-

153. See *GTE Sylvania*, 433 U.S. at 55 & n.23 (discussing use of vertical restraints to maintain goodwill); R. BORK, *supra* note 45, at 379-80 (praising the goodwill defense in tying cases); W. BOWMAN, *supra* note 51, at 173-76 (discussing goodwill defense).

154. 80 F.2d 641 (7th Cir. 1935), *aff'd per curiam*, 299 U.S. 3 (1936).

155. *Id.* at 644; see *Fortner I*, 394 U.S. 495, 514 n.9 (1969) (tie-in "may protect the reputation of the tying product if failure to use the tied product in conjunction with it may cause it to malfunction"), quoted in *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 104 S. Ct. 1551, 1574 (1984) (O'Connor, J., concurring); W. BOWMAN, *supra* note 51, at 174-75 (discussing *Pick* and related cases); see also *IAP, Inc. v. Mercedes-Benz of N. Am.*, 571 F. Supp. 262, 267 (D.N.J. 1983) (applying *Pick* in analogous suit involving Mercedes-Benz). But see *Metrix Warehouse, Inc., v. Daimler-Benz Aktiengesellschaft*, 1984-2 Trade Cas. (CCH) ¶ 66,226, at 66,947 (D. Md. 1984) (suggesting that *Pick* is inconsistent with *Jefferson Parish Hosp.*). A number of cases have upheld goodwill justifications for tying arrangements. See, e.g., *Baker v. Simmons Co.*, 307 F.2d 458 (1st Cir. 1962) (upholding tie-in to maintain trademark holder's goodwill), *cert. denied*, 382 U.S. 820 (1965); see also ABA MONOGRAPH, *supra* note 136, at 12-13, 18-20 (discussing the goodwill justification); C. HILLS, *supra* note 21, at 109-13 (same). Goodwill was also one of the considerations in *United States v. Jerrold Elecs. Corp.*, 187 F. Supp. 545, 556-60 (E.D. Pa. 1960) (discussing good will and new industry justifications), *aff'd per curiam*, 365 U.S. 567 (1961). See Austin, *The Tying Arrangement: A Critique and Some New Thoughts*, 1967 Wis. L. REV. 88, 122 (arguing that *Jerrold* is based on a combination of goodwill, single product, and new industry defenses); see also *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 104 S. Ct. at 1570 n.1 (O'Connor, J., concurring) (discussing *Jerrold* as a goodwill case).

156. 292 F.2d 653, 656-67 (1st Cir.), *cert. denied*, 368 U.S. 931 (1961).

157. *Id.* at 654; see W. BOWMAN, *supra* note 51, at 175-76 (discussing *Dehydrating Process* and related cases).

158. *GTE Sylvania*, 433 U.S. at 55 n.23; see *Tripoli Co. v. Wella Corp.*, 425 F.2d 932, 936-39 (3d Cir.) (allowing tie-in intended to avoid product liability suits), *cert. denied*, 400 U.S. 831 (1970). Governing federal provisions include the Consumer Product Safety Act, 15 U.S.C. §§ 2051-83 (1982) (safety regulations), and the Consumer Product Warranties Act, 15 U.S.C. §§ 2301-12 (1982) (warranty obligations); see J. INMAN, *THE REGULATORY ENVIRONMENT OF BUSINESS* 541-71 (1984) (discussing state and federal safety requirements), R. MLINERS & A. RINGLER, *THE LEGAL ENVIRONMENT OF BUSINESS* 98-175 (1982) (discussing state and federal quality and safety requirements); L. STERN & T. EDOALDI, *LEGAL ASPECTS OF MARKETING STRATEGY* 76-116 (1984) (discussing numerous legal rules that mandate product quality and safety).

in must be "fairly necessary" to protect goodwill.¹⁵⁹ For example, in *International Business Machines v. United States*,¹⁶⁰ IBM claimed that its requirement that only IBM computer cards be used with its tabulating machine was intended to prevent malfunctions resulting from the use of inferior cards.¹⁶¹ The Supreme Court rejected the defense because a less restrictive alternative was available: IBM could provide consumers with quality specifications for the tabulating cards.¹⁶² Defendants seeking to justify a tie-in must therefore show that either quality specifications "would be so detailed that they could not practicably be supplied,"¹⁶³ or the use of quality specifications would reveal trade secrets.¹⁶⁴ In *Data General*, the trial court acknowledged that quality specifications would be inadequate and would result in disclosure of trade secrets.¹⁶⁵ There are at least three ways to distinguish *Data General* from cases where quality specifications are adequate. The first is that specifications for compatible computer hardware are probably too detailed to be reasonable.¹⁶⁶ In addition, as the court noted, specifications might reveal trade secrets.¹⁶⁷ Finally, *Data General*'s sales are often made to middlemen who may not pass on the specifications to final purchasers.¹⁶⁸

159. *Principe v. McDonald's Corp.*, 631 F.2d 303, 311 (4th Cir. 1980) (franchisor's tie-in upheld as necessary to franchising process), *cert. denied*, 451 U.S. 970 (1981); *Anderson v. AAA*, 454 F.2d 1240, 1246 (9th Cir. 1972) ("fairly necessary" test for vertical restrictions); *see also infra* note 162.

160. 298 U.S. 131 (1936).

161. *Id.* at 138-39. The purpose of the tie-in in *IBM* may well have been "metering" of demand as part of a price discrimination scheme. *See supra* note 56 and accompanying text.

162. *IBM Corp. v. United States*, 298 U.S. 131, 139-40 (1936). The availability of product specifications as a less restrictive alternative is frequently the rationale for rejecting goodwill justifications. *See, e.g., Standard Oil Co. v. United States*, 337 U.S. 293, 305-06 (1949); *International Salt Co. v. United States*, 332 U.S. 392, 397-98 (1947); *Moore v. Jas. H. Matthews & Co.*, 350 F.2d 1207, 1217 (9th Cir. 1977).

163. *Standard Oil Co. v. United States*, 337 U.S. 293, 306 (1949); *see Krehl v. Baskin-Robbins Ice Cream Co.*, 664 F.2d 1348, 1353 (9th Cir. 1982) (discussing less restrictive alternatives to tying arrangements); *Principe v. McDonald's Corp.*, 631 F.2d 303, 308-11 (4th Cir. 1980) (same), *cert. denied*, 451 U.S. 970 (1981); *Siegel v. Chicken Delight, Inc.*, 448 F.2d 43, 50-52 (9th Cir. 1971) (same), *cert. denied*, 405 U.S. 955 (1972); *Susser v. Carvel Corp.*, 332 F.2d 505, 519-20 (2d Cir. 1964) (same), *cert. dismissed*, 381 U.S. 125 (1965); *Dehydrating Process Co. v. A. O. Smith Corp.*, 292 F.2d 653, 656 (1st Cir.) ("It may be assumed . . . that defendant did not readily escape claims, or the consequent injury to its reputation, by telling its customers that the fault was theirs."), *cert. denied*, 368 U.S. 931 (1961).

164. *See Siegel v. Chicken Delight, Inc.*, 448 F.2d 43, 51 n.9 (9th Cir. 1971) (goodwill justification might be accepted if specifications would reveal trade secrets), *cert. denied*, 405 U.S. 955 (1972).

165. *Data General I*, 490 F. Supp. 1089, 1121 (N.D. Cal. 1980), *aff'd in part*, 734 F.2d 1336 (9th Cir. 1984), *cert. denied*, 105 S. Ct. 3534 (1985).

166. *See supra* note 163, *cf. IBM Corp. v. United States*, 298 U.S. 131, 139-40 (1936) (specification of computer cards found to be reasonable alternative).

167. *See supra* note 164.

168. *Compare Data General II*, 529 F. Supp. 801, 805 (N.D. Cal. 1981) (noting that *Data General*'s customers resell completed computer systems to end users), *rev'd in part*, 734 F.2d 1336 (9th Cir. 1984), *cert. denied*, 105 S. Ct. 3534 (1985), and *Pick Mfg. Co. v. General Motors Corp.*, 80 F.2d

Although the evidence adduced by Data General might be viewed as proof that its tie-in was fairly necessary to protect its goodwill,¹⁶⁹ the court proceeded to suggest a different less restrictive alternative. It held—without citing any case authority—that Data General could offer “lesser warranties” or “decline to provide service” when its software was used with hardware made by other firms.¹⁷⁰ The fact that the limited warranty might be more costly to consumers was not considered.¹⁷¹ Nor was the effectiveness of the alternatives discussed.¹⁷² Indeed either scheme suggested by the court could harm Data General’s goodwill more than would the use of incompatible hardware. The notion that providing lesser warranties or denying service would protect Data General’s goodwill is, at a minimum, counterintuitive. Warranties and product service are methods of protecting goodwill because they can prevent buyers from becoming dissatisfied. Limitations on post-purchase service are likely to harm a company’s reputation and goodwill, if not lead to legal action by consumers.¹⁷³ Moreover, warranties are signals to buyers; buyers view generous warranties as an assurance of product quality and reliability.¹⁷⁴ Consumer protection laws also constrain a manufacturer’s ability to limit warranties.¹⁷⁵ As the United States Court of Appeals for the Third Circuit has noted:

Application of the rigid “no less restrictive alternative” test . . . would place an undue burden on the ordinary conduct of business. Entrepreneurs . . . would then be made guarantors that the imaginations of lawyers could not conjure up some method of achieving the business purpose in question that would result in a somewhat lesser restriction of trade. And courts would be placed in the position of second-guessing business judgments as to what arrangements would or would not provide “adequate” protection for legitimate commercial interests.¹⁷⁶

639, 642 (7th Cir. 1935) (GM sold parts to dealers who installed them in GM cars) with *IBM Corp. v. United States*, 298 U.S. 131, 139-40 (1936) (IBM can “[proclaim] the virtues of its own cards or [warn] against” use of other cards).

169. See generally *supra* note 159.

170. *Data General I*, 490 F. Supp. 1089, 1121 (N.D. Cal. 1980), *aff’d in relevant part*, 734 F.2d 1336 (9th Cir. 1984), *cert. denied*, 105 S. Ct. 3534 (1985).

171. *Id.* (“[C]osts could simply be passed along to consumers who choose an unbundled, lesser warranty option.”).

172. *Cf. supra* note 163 (citing cases where less restrictive alternatives were regarded as impractical).

173. See *supra* note 158 and accompanying text.

174. See Whitford, *Comment on a Theory of the Consumer Product Warranty*, 91 *YALE L.J.* 1371, 1373, 1379-80 (1982) (discussing the signal theory). But cf. Gerner & Bryant, *Appliance Warranties as a Market Signal?* 15 *J. CONSUMER AFF.* 75, 78-79 (1981) (contending that consumers generally look with favor on the existence of warranties but rarely spend much time and energy evaluating specific warranty provisions).

175. See *supra* note 158.

176. *American Motor Inns v. Holiday Inns*, 521 F.2d 1230, 1249-50 (3d Cir. 1975). One commentator has noted that *Data General* is “[a]n example of the extent to which courts’ belief in the

In *GTE Sylvania*, the Supreme Court highlighted the need to focus on demonstrable economic effect, not "formalistic line drawing."¹⁷⁷ By ignoring the possibility that "lesser warranties" are inferior to tie-ins as a means of protecting goodwill, the *Data General* court failed to adhere to Supreme Court precedent.

B. *Economies of Joint Production and Sale.*

The joint production and sale of two products may result in substantial cost savings to consumers. As noted in *GTE Sylvania*, these savings occur because a tying arrangement may promote "marketing efficiency."¹⁷⁸ An auto manufacturer, for instance, "ties" the various components of a car in order to create a substantial efficiency gain.¹⁷⁹ Where this is the case, courts sometimes characterize the package as one product and thus hold that the two-product requirement is not met.¹⁸⁰ Simi-

supposed availability of less restrictive alternatives will be carried." C. HILLS, *supra* note 21, at 157 (Supp. 1983). The tendency of courts to suggest speculative or inadequate alternatives to tying arrangements has been criticized by several commentators. See, e.g., R. BORK, *supra* note 45, at 380 ("There is no showing that . . . alternative routes will be as effective as the tie-in of the related product, or that they will accomplish the result as inexpensively."); R. POSNER, *supra* note 26, at 175-76 (specifications alternative is often less efficient than tie-in).

177. *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 58-59 (1977).

178. *Id.* at 55; see *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 104 S. Ct. 1551, 1573 (1984) (O'Connor, J., concurring) ("When the economic advantages of joint packaging are substantial the package is not appropriately viewed as two products, and that should be the end of the tying inquiry."). Cost savings are particularly likely when the two products "are used in fixed proportions." ABA MONOGRAPH, *supra* note 136, at 26. It is thus possible to contrast *Data General* I, 490 F. Supp. 1089, 1104 (N.D. Cal. 1980), *aff'd in part*, 734 F.2d 1336 (9th Cir. 1984), *cert. denied*, 105 S. Ct. 3534 (1985), where the tied hardware and software were used in fixed proportions, with *IBM Corp. v. United States*, 298 U.S. 131, 133-34 (1936), where the tabulating cards were not used in fixed proportions.

179. This example is noted in R. BORK, *supra* note 45, at 378-79.

180. The existence of two separate products is one of the defining elements of tying arrangements. See *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 104 S. Ct. 1551, 1563 (1984) (discussing "two product" requirement); see also *supra* note 23 and accompanying text. Many cases have focused on the separate product issue where the tie-in produced efficiencies of joint production and sale. See ABA MONOGRAPH, *supra* note 136, at 26 (tie-in of advertising in morning and afternoon newspapers characterized as one product) (citing *Times-Picayune Publishing Co. v. United States*, 345 U.S. 594, 613-15 (1953)); see also *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 104 S. Ct. 1551, 1573 (1984) (O'Connor, J., concurring) ("When the economic advantages of joint packaging are substantial the package is not appropriately viewed as two products . . ."); *Hirsh v. Martindale-Hubbell, Inc.*, 674 F.2d 1343, 1347-49 (9th Cir.) (same), *cert. denied*, 459 U.S. 973 (1982); *Siegel v. Chicken Delight, Inc.*, 448 F.2d 43, 48 (9th Cir. 1971) (same), *cert. denied*, 405 U.S. 955 (1972); *Associated Press v. Taft-Ingalls Corp.*, 340 F.2d 753, 759-64 (6th Cir.) (same), *cert. denied*, 382 U.S. 820 (1965); *United States v. Mercedes-Benz of N. Am., Inc.*, 517 F. Supp. 1369, 1379-81 (N.D. Cal. 1981) (same); R. BORK, *supra* note 45, at 379 (noting that courts have attempted to deal with economies of scale by characterizing package as one product). The district court in *Data General* also noted potential cost savings in its discussion of the two-product issue. *Data General* I, 490 F. Supp. 1089, 1104-07 (N.D. Cal. 1980), *aff'd in part*, 734 F.2d 1336 (9th Cir. 1984), *cert. denied*, 105 S. Ct. 3534 (1985).

larly, in two blanket licensing cases, the courts have assumed that such an arrangement results in the creation of a single, new product.¹⁸¹

181. A blanket license gives the licensee the right to perform or use all of the copyrighted compositions in the licensor's repertoire. Blanket licensing is not a classic tie-in because it involves no actual conditioning or "tying" of two products. After all revenues from the blanket licensing are collected, they are allocated to particular compositions based on actual use. The most famous anti-trust challenge to this practice alleged that it constituted price fixing in violation of section 1 of the Sherman Act. *Broadcast Music, Inc. v. CBS*, 441 U.S. 1, 6 (1979). Noting the "substantial lowering of costs" and the fact that the blanket license "is, to some extent, a different product," the Supreme Court refused to apply the per se rule to BMI. *Id.* at 21-25. In *F.E.L. Publications, Ltd. v. Catholic Bishop*, 214 U.S.P.Q. 409 (7th Cir. 1982), a copyright infringement action, the United States Court of Appeals for the Seventh Circuit invoked BMI when it refused to characterize the blanket licensing of religious songs as an unlawful tying arrangement. *Id.* at 413-16; see also *Broadcast Music, Inc. v. Moor-Law, Inc.*, 527 F. Supp. 758 (D. Del. 1981) (refusing to characterize blanket licensing as a tie-in), *aff'd without opinion*, 691 F.2d 490 (3d Cir. 1982) and 691 F.2d 491 (3d Cir. 1982). The court, focusing on the efficiencies of blanket licensing, concluded that the practice created a unique product. *F.E.L. Publications*, 214 U.S.P.Q. at 413-14. The Supreme Court likewise focused upon the curing of market imperfections when it upheld the Chicago Board of Trade's "Call rule" against a section 1 price fixing challenge. *Chicago Bd. of Trade v. United States*, 246 U.S. 231, 240-41 (1918) (Call rule "improve[d] market conditions"); see also *NCAA v. Board of Regents*, 104 S. Ct. 2948, 2960-62 (1984) (refusing to apply per se rule against price fixing where the restraint was necessary to create the product in question).

A related business justification sometimes raised in tie-in cases is the "free rider" defense. For a general introduction to the free rider/public good problem, see J. HIRSHLEIFER, *PRICE THEORY AND APPLICATIONS* 561-64 (2d ed. 1980). *Data General*, for example, claimed that it needed to bundle its hardware and software in order to recoup its investment in software research and development. *Data General I*, 490 F. Supp. 1089, 1121-22 (N.D. Cal. 1980), *aff'd in part*, 734 F.2d 1336 (9th Cir. 1984), *cert. denied*, 105 S. Ct. 3534 (1985). As one trade journal pointed out after the decision in *Data General*:

[T]here will be little incentive for a company to invest the money necessary to develop a unique or innovative [computer] system. Competitors will simply wait to see how commercially successful the system is. If it is a "hit," there will be a flood of "compatible" products, all piggybacking on the software R&D done by the innovator. If it is a "flop," then the competitors will turn elsewhere, leaving the innovator to shoulder the loss.

Appellate Court Reinstates Antitrust Verdict Against Data General, SCOTT REPORT, June 1984, at 1, 6; see *Monsanto Co. v. Spray-Rite Serv. Corp.*, 465 U.S. 752, 762-63 (1984) (discussing free rider problem in resale price maintenance context); *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 55 (1977) ("Because of market imperfections such as the so-called 'free rider' effect . . . services might not be provided by retailers in a purely competitive situation, despite the fact that each retailer's benefit would be greater if all provided the services than if none did."); *Berkey Photo, Inc. v. Eastman Kodak Co.*, 603 F.2d 263, 281 (2d Cir. 1979) (monopolization case) ("If a firm that has engaged in the risks and expenses of research and development were required in all circumstances to share with its rivals the benefits of those endeavors, [creative] incentives would very likely be vitiated."), *cert. denied*, 444 U.S. 1093 (1980); *Moor-Law*, 527 F. Supp. at 763 (discussing free rider problem in blanket licensing context); see also ABA MONOGRAPH, *supra* note 136, at 25 (discussing, in tying arrangement context, "reallocat[ion] of costs or profits" justification derived from *Fortner II*); Easterbrook, *supra* note 45, at 146 (discussing role of tying arrangements in facilitating innovation); Easterbrook, *Predatory Strategies and Counterstrategies*, 48 U. CHI. L. REV. 263, 307-12 (1981) (tie-in enables firm to recoup investment in information); Lipsky, *Current Antitrust Division Views on Patent Licensing Practices*, 50 ANTITRUST L.J. 515, 518 (1982) (same). A "free rider" defense would thus be consistent with the copyright law's goal of encouraging innovation in computer technology. See Samuelson, *supra* note 42, at 671 n.26; see also R. BOWKER, *COPYRIGHT: ITS HISTORY AND ITS LAW* 50 (1912) (quoting Senator O.M. Platt) ("The very essence of copyright is

Although it is true that efficiency gains are considered during analysis of the separate products issue,¹⁸² the complex and confusing tests applied at that stage of a case may not adequately account for the benefits of the tying arrangement.¹⁸³ Given the consumer welfare-efficiency goal of antitrust law and the concern for "redeeming virtues" in *GTE Sylvania*,¹⁸⁴ the courts should analyze economies of joint production and sale as an affirmative defense.

V. CONCLUSION

The legal proscriptions against tying arrangements have received increasing criticism in recent years. Commentators viewing the problem from the economic perspective have been particularly critical of the mechanistic nature of the law. First, in the interest of judicial economy, courts often seem unwilling to delve into complex questions such as market power. Second, the courts' uncritical adherence to precedent often causes them to apply economic reasoning that has long been discredited by economists.

These problems are illustrated in *Data General*. The partial per se rule of tying arrangements requires a showing of actual economic power. The *Data General* court, however, seemed unwilling to analyze evidence tending to disprove market power. Instead the court sought to rely upon

the privilege of controlling the market[, because t]hat is the only way in which a man's property in the works of his brain can be assured.").

182. See *supra* note 180.

183. The legal test for determining whether there are one or two products "turns not on the functional relation between them, but rather on the character of the demand for the two items." *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 104 S. Ct. 1551, 1562 (1984). This standard has been criticized by several commentators. See *Dam, supra* note 66, at 19 (noting abstract nature of two-product analysis), quoted in *Jefferson Parish Hosp.*, 104 S. Ct. at 1563 n.33; see also ABA ANTI-TRUST SECTION, *supra* note 21, at 79 ("Courts generally have examined whether separate products exist on a case-by-case basis without attempting to set forth a systematic standard for making this determination.") (footnote omitted); ABA MONOGRAPH, *supra* note 136, at 5-8 (noting that test involves "a normative rather than objective inquiry" and discussing various factors that courts consider); R. BORK, *supra* note 45, at 378-79 (criticizing one-product, two-product distinction); C. HILLS, *supra* note 21, at 207-09 (W. Liebler ed. Supp. 1984) (criticizing standards used in determining separate-products issue). As Posner notes:

We think of a mimeograph machine and its paper and ink as separate products which if sold together are "tied," but we do not think of a left and right glove, or an automobile and its radiator, in the same way. Yet nothing in the traditional legal thinking about tie-ins enables one to distinguish among these cases. . . . I suppose what keeps the doctrine from expanding to its logical limits is a tacit assumption that the more obvious combination sales could be readily justified by their lower costs. . . . But there is something seriously wrong about a doctrine under which virtually every combination sale is *prima facie* an unlawful tie-in

R. POSNER, *supra* note 26, at 181.

184. See *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 54-55 (1977); see also *supra* note 45.

the existence of a copyright, vague generalizations about the "special attraction of RDOS," and the presence of a "lock in."¹⁸⁵ Further, the court relied on the unsound leverage or transfer-of-power theory.¹⁸⁶

Almost any firm in the computer industry that sells hardware and software as a package would be liable for treble damages under the *Data General* court's presumption of economic power, its minimal requirement as to market power, and its rapid dismissal of business justifications. The same threat of liability would exist regardless of the size of the firm, as long as it held a copyright or a patent on the tying product. Under the *Data General* approach, the competitive nature of the computer industry would be ignored, and even the most persuasive business justifications might be rejected. This result would indeed be harsh. More importantly, it would be a result that is inconsistent with the main goal of the antitrust laws: improving consumer welfare by fostering competition.

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185. *Digidyne Corp. v. Data General Corp.*, 734 F.2d 1336, 1341-43 (9th Cir. 1984), cert. denied, 105 S. Ct. 3534 (1985).

186. See, e.g., *id.* at 1340.

THE PRESUMPTION OF ECONOMIC POWER FOR PATENTED AND COPYRIGHTED PRODUCTS IN TYING ARRANGEMENTS

INTRODUCTION

Tying arrangements¹ have been subject to especially harsh treatment under the antitrust laws.² For almost forty years, they have been subject to a rule of per se illegality³ that precludes the burdensome and lengthy trials that often occur under the rule of reason.⁴ The per se

1. For the purposes of this Note, a tying arrangement is defined as "an agreement by a party to sell one product but only on the condition that the buyer also purchases a different (or tied) product, or at least agrees that he will not purchase that product from any other supplier." *Northern Pac. Ry. v. United States*, 356 U.S. 1, 5-6 (1958).

2. Tie-ins may violate § 1 of the Sherman Act and in addition they may violate § 3 of the Clayton Act. Section 1 of the Sherman Act provides in relevant part: "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal." 15 U.S.C. § 1 (1982). Section 3 of the Clayton Act provides in relevant part:

It shall be unlawful for any person engaged in commerce, in the course of such commerce, to lease or make a sale or contract for sale of goods, wares, merchandise, machinery, supplies, or other commodities, whether patented or unpatented, for use, consumption, or resale within the United States . . . or fix a price charged therefore, or discount from, or rebate upon, such price, on the condition, agreement, or understanding that the lessee or purchaser thereof shall not use or deal in the goods, wares, merchandise, machinery, supplies, or other commodities of a competitor or competitors of the lessor or seller, where the effect of such lease, sale, or contract for sale or such condition, agreement, or understanding may be to substantially lessen competition or tend to create a monopoly in any line of commerce.

15 U.S.C. § 14 (1982). It is now recognized that the standard of analysis is the same under both statutes. See *Moore v. Jas. H. Matthews & Co.*, 550 F.2d 1207, 1214 (9th Cir. 1977) (standards are "virtually identical"). The more general language of § 1 of the Sherman Act, however, reaches a variety of tie-ins not covered by the Clayton Act, which is restricted to transactions where the tying and tied products are "goods, wares, merchandise, machinery, supplies, or other commodities" and do not involve services.

3. One of the earliest enunciations of a per se rule for tying arrangements can be found in *International Salt Co. v. United States*, 332 U.S. 392, 395-96 (1947). The rule has developed into a formal three-part inquiry. First, there must be separate products, the sale of one, the tying product, being conditioned on the purchase of the other, the tied product. Second, the seller must have sufficient economic power with respect to the tying product to restrain competition appreciably in the tied product. Finally, the tie must have an effect upon a substantial amount of commerce in the tied product. See, e.g., *Digidyne Corp. v. Data General Corp.*, 734 F.2d 1336, 1338 (9th Cir. 1984), cert. denied, 53 U.S.L.W. 3910 (U.S. June 25, 1985).

However, in the most recent tie-in case considered by the Supreme Court, four justices advocated the abandonment of the per se rule and the consideration of all tie-ins under a rule of reason approach. See *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 104 S. Ct. 1551, 1569 (1984) (O'Connor, J., concurring).

4. For a discussion of the complexity and length of antitrust litigation under the rule of reason, see McAllister, *The Big Case: Procedural Problems in Antitrust Litigation*, 64 Harv. L. Rev. 27 (1950).

test requires that a seller have sufficient economic power over a tying product such that he can compel some buyers to purchase another product.⁵ In some instances, a showing of actual market power is not necessary to satisfy the test. In particular, if the tying product is patented⁶ or copyrighted,⁷ the requisite economic power is presumed.⁸ Two recent conflicting lower court decisions, however, indicate uncertainty as to the viability of this presumption.

This Note first traces the development of the presumption and examines the recent cases that have drawn it into question. It then examines the more recent developments in tie-in doctrine made by the Supreme Court. The Note concludes that the presumption does not serve as an adequate proxy for evidence of actual economic power, is not consistent with current antitrust doctrine, and should be rejected.

I. DEVELOPMENT OF THE PRESUMPTION

A. Early Cases Establishing the Presumption

Tying arrangements involving patented products were examined several times by the Supreme Court in the fifty years following the passage of the Sherman Act. During that time, the Court became increasingly hostile toward such arrangements.⁹ In 1947, in *International Salt Co. v. United States*,¹⁰ the Court moved towards a per se condemnation of such tying arrangements. International Salt leased patented salt processing machines to various processors, but required that the processors purchase all of their salt from International Salt.¹¹ In evaluating the legality of the tying arrangement, the Court looked to the pat-

5. See, e.g., *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 104 S. Ct. 1551, 1558-59 (1984).

6. See *id.* at 1560.

7. See *United States v. Loew's, Inc.*, 371 U.S. 38, 45-47 (1962).

8. This same "strict rule" that makes a showing of actual market power unnecessary also applies when the seller's share of the market is high, see *Times-Picayune Publishing Co. v. United States*, 345 U.S. 594, 611-13 (1953), or when the seller offers a unique product that competitors are not able to offer, see *Fortner Enters., Inc. v. United States Steel Corp.*, 394 U.S. 495, 504-06 (1969) (*Fortner I*), or perhaps when the tying product is trademarked. Compare *Siegel v. Chicken Delight, Inc.*, 448 F.2d 43, 50 (9th Cir. 1971) (yes), with *Susser v. Carvel Corp.*, 332 F.2d 505, 518-21 (2d Cir. 1964) (no).

9. W. Bowman, *Patent and Antitrust Law* 163-80 (1973).

10. 332 U.S. 392 (1947).

11. *Id.* at 394. International Salt held patents on two processing machines. One, the "Lixator," dissolved rock salt into a brine used in various industrial products. The other, the "Saltomat," injected salt, in tablet form, into canned products during the canning process. The leasing contracts provided that the lessees of the machines purchase all of their salt from International Salt at the market price. It has been suggested that the leasing contracts were an attempt by International Salt to "meter" the use of the machines, charging a higher price for those who use the machines more. See M. Handler, H. Blake, R. Pitofsky, & H. Goldschmid *Trade Regulation* 1144 (2d ed. 1983). The fact that the salt was sold at the market price makes this unlikely. See Peterman, *The International Salt Case*, 22 J.L. & Econ. 351, 352-59 (1979).

ent misuse doctrine, which denies any relief against patent infringement if the patent owner markets the patented product through the use of a tying arrangement.¹² The Court reasoned as follows: "[The] patents confer a limited monopoly of the invention they reward. . . . But the patents confer no right to restrain use of, or trade in, unpatented salt."¹³ Without more, the Court found the tying clauses to be per se violations of section one of the Sherman Act and section three of the Clayton Act.¹⁴ Although it is somewhat unclear how much weight the Court placed on the fact that the machines were patented, *International Salt* has come to stand for the proposition that a tie-in in which the tying product is patented is per se illegal.¹⁵

The Supreme Court relied on *International Salt* in deciding the two block-booking cases in which the Court developed its approach to tying arrangements involving copyrighted products. Block-booking is an arrangement whereby a film distributor licenses one film or group of films only on the condition that the exhibitor lease another film or group of films. In the first case involving block-booking, *United States v. Paramount Pictures Inc.*,¹⁶ the Court once again looked to the patent misuse doctrine.¹⁷ It viewed Paramount's block-booking as an attempt to extend its copyright monopoly, the same type of behavior that the Court, in the context of patents, had condemned in *International Salt*. The Court held that tying the licensing of certain copyrighted feature films to other films was per se illegal.¹⁸

12. The Court had recently decided three patent misuse cases in which it displayed extreme hostility toward tie-ins of patented products. See *Mercoid Corp. v. Minneapolis-Honeywell Regulator Co.*, 320 U.S. 680 (1944); *Mercoid Corp. v. Mid-Continent Inv. Co.*, 320 U.S. 661 (1944); *Morton Salt Co. v. G.S. Suppiger Co.*, 314 U.S. 488 (1942).

13. 332 U.S. at 395-96.

14. See *id.* at 393, 396.

15. The opinion in *International Salt* is confusing and has been accorded varying interpretations by the Supreme Court. In *Northern Pac. Ry. v. United States*, 356 U.S. 1 (1958), the Court, per Justice Black, noted that the tying arrangement in *International Salt* was found to be "unlawful despite the fact that the tying item was patented, not because of it." *Id.* at 9 (emphasis in original). "[T]he Court placed no reliance on the fact that a patent was involved" *Id.* This was followed by a footnote with the observation that the "economic power resulting from [some] patent privileges is slight." *Id.* at 10 n.8. This suggests that tie-ins involving a patented product were not subject to any more rigorous scrutiny. Indeed, Justice Black's choice of language hints that such arrangements might even warrant more tolerance than others would. Justice Harlan, in dissent, criticized the majority for what he viewed as a confused interpretation of *International Salt*. He insisted that the case should be interpreted as stating that patents should be treated "as the equivalent of proof of market control." *Id.* at 18. Just five years later, the Court insisted that tying arrangements involving patented products were per se violations of the Sherman Act, since they are "bald effort[s] to enlarge the monopoly of the patent beyond its terms," and cited *International Salt* for support. See *White Motor Co. v. United States*, 372 U.S. 253, 259 (1963).

16. 334 U.S. 131 (1948).

17. See *supra* note 12 and accompanying text.

18. 334 U.S. at 156-59.

The second block-booking case followed two Supreme Court tying-arrangement decisions involving neither patents nor copyrights.¹⁹ In these two cases the Court began to focus on the tying arrangement's potential for actual economic harm. This necessitated an examination of the seller's power in the market for the tying product. In the first of the two cases, the Court indicated that the seller would need to possess either "monopoly power" or "dominance" in the market for the tying product as a necessary precondition to a per se condemnation of the arrangement.²⁰ However, the Court quickly retreated in the next case and required nothing more than that the seller have "sufficient economic power with respect to the tying product to appreciably restrain free competition in the market for the tied product."²¹

When the Court was faced with the second block-booking case, *United States v. Loew's, Inc.*,²² the intervening cases necessitated a change in the framework of its analysis of tying arrangements. Although the facts in *Loew's* were almost identical to those in *Paramount Pictures*,²³ the Court could no longer rely exclusively on the extension of a patent or copyright monopoly as the rationale for condemning the tie. Without proof of "sufficient economic power,"²⁴ per se condemnation was no longer warranted. The Court satisfied this requirement simply by stating that the "requisite economic power is presumed when the tying product is patented or copyrighted."²⁵ As support for this proposition, the Court cited *International Salt* and *Paramount Pictures*.²⁶ Although these cases had condemned tying arrangements involving patented and copyrighted products, neither had made any mention of the market power of the tying product since they had been decided before any market power requirement existed.

The Court indicated the theoretical basis for this presumption of market power by noting that it is not necessary to demonstrate market dominance in order to show that the seller has the requisite economic power. Rather, "economic power may be inferred from . . . uniqueness in [the tying product's] attributes."²⁷ Since one of the objectives of the patent laws is to reward uniqueness, "the existence of a valid patent on the tying product, without more, establishes distinctiveness sufficient to conclude that any tying arrangement involving the pat-

19. See *Northern Pac. Ry. v. United States*, 356 U.S. 1 (1958); *Times-Picayune Publishing Co. v. United States*, 345 U.S. 594 (1953).

20. See *Times-Picayune*, 345 U.S. at 611.

21. *Northern Pacific*, 356 U.S. at 6.

22. 371 U.S. 38 (1962).

23. In *Paramount Pictures*, the distributors were licensing the films to movie theater exhibitors, while in *Loew's* the licensees were television stations.

24. *Northern Pacific*, 356 U.S. at 6.

25. 371 U.S. at 45.

26. See *id.* at 45-46.

27. *Id.* at 45.

ented product would have anticompetitive consequences."²⁸ The Court then insisted that this reasoning had been extended to copyrighted films in *Paramount Pictures*.²⁹ The Court accordingly found the block-booking contracts in *Loew's* to be per se violations of section one of the Sherman Act.

Loew's is the most recent case in which the Court examined the validity of a tie-in involving either patents or copyrights. However, the presumption³⁰ has proved to be a standard refrain for the Court, which reiterates in each tying arrangement case that if the tying product is patented or copyrighted, the seller's economic power can be presumed.³¹

28. *Id.* at 46.

29. See *id.*

30. The fact that the economic power is presumed raises the issue of whether the presumption is rebuttable or conclusive. While the Court's decisions have not been models of clarity as to this issue, indications are that the presumption is conclusive. Agreement with this position can be found as recently as *Jefferson Parish Hosp. Dist. No. 2 v. Hyde* where the Court noted that the "sale or lease of a patented item on condition that the buyer make all his purchases of a separate tied product from the patentee is unlawful." 104 S. Ct. 1551, 1560 (1984). Lower courts have not been unanimous in deciding whether the presumption is conclusive or rebuttable. Compare *Hazeltine Research, Inc. v. Zenith Radio Corp.*, 388 F.2d 25, 35 (7th Cir. 1967), *aff'd* in part and *rev'd* in part, 395 U.S. 100 (1969) (liability based on a conclusive presumption of economic power resulting from the existence of the patents), and *Duplan v. Deering Milliken, Inc.*, 444 F. Supp. 648, 673 (D.S.C. 1977), *aff'd* in part and *rev'd* in part, 594 F.2d 979 (4th Cir. 1979), *cert. denied*, 444 U.S. 1015 (1980) (stating that "the power of the patentee to require a licensee to purchase a different product is unquestioned"), with *Digidyne Corp. v. Data General Corp.*, 734 F.2d 1336, 1344 (9th Cir. 1984) (existence of copyright creates rebuttable presumption of sufficient economic power), *cert. denied*, 53 U.S.L.W. 3910 (U.S. June 25, 1985), and *Susser v. Carvel Corp.*, 332 F.2d 505, 520 (2d Cir. 1964), *cert. dismissed*, 381 U.S. 125 (1965) (existence of patent does not suffice "semper et ubique" to show market power); see also 2 E. Kintner, *Federal Antitrust Laws* § 10.57 (1980) ("Economic power is [conclusively] presumed from a patent or copyright.").

31. See, e.g., *Hyde*, 104 S. Ct. at 1560; *U.S. Steel Corp. v. Fortner Enters., Inc.*, 429 U.S. 610, 619 (1977) (*Fortner II*).

Justice O'Connor's concurrence in *Hyde* strongly challenged this proposition. She insisted that:

A common misconception has been that a patent or copyright . . . suffice[s] to demonstrate market power. While [this] might help to give market power to a seller, it is also possible that a seller in [such a situation] will have no market power: for example, a patent holder has no market power in any relevant sense if there are close substitutes for the patented product.

104 S. Ct. at 1572 n.7. This reasoning applies equally to products that are copyrighted. Justice O'Connor continued:

Nor does any presumption of market power find support in our prior cases. Although *United States v. Paramount Pictures, Inc.* . . . considered the legality of "block booking" of motion pictures, . . . the Court did not analyze the arrangement with the schema of the tying cases. Rather, the Court borrowed the patent law principle of "patent misuse," which prevents the holder of a patent from using the patent to require his customers to purchase unpatented products.

B. Lower Courts Questioning the Presumption

Two recent decisions evidence judicial uncertainty as to the continuing viability of the presumption. The two decisions, although adopting different approaches and reaching opposite conclusions, both rejected the doctrine that the mere existence of a copyright, without more, establishes economic power.

In the first case, *Digidyne Corp. v. Data General Corp.*,³² the Ninth Circuit held that a tie-in in which the tying product, computer software, was copyrighted constituted a per se antitrust violation. The court refused to find that the copyright presumption was conclusive, stating instead that it is prima facie evidence of sufficient market power and shifts the burden of persuasion to the defendant to show that the requisite economic power does not exist.³³ Because courts have relied on the uniqueness of a product to demonstrate market power, the defendant had to show that its product was not unique.³⁴ The court greatly limited the type of evidence that could be used to rebut the presumption. The defendant attempted to show that adequate substitutes existed to the tying computer software. However, the court, citing *International Salt* and *Loew's*,³⁵ determined that such evidence was irrelevant, stating that "the adverse impact on competition . . . is not diminished by the fact that other sellers may be selling products similar to the tying product."³⁶

In the second case, *3 P.M., Inc. v. Basic Four Corp.*,³⁷ the district court refused to acknowledge the existence of a presumption of market power for copyrighted tying products.³⁸ The court stated that the existence of a copyright is not sufficient to show economic power under the per se rule.³⁹ The court reached this conclusion by insisting on a narrow factual reading of *Loew's*. Under its interpretation, *Loew's* did

Id. (citations omitted).

32. 734 F.2d 1336 (9th Cir. 1984), cert. denied, 53 U.S.L.W. 3910 (U.S. June 25, 1985).

33. Id. at 1344.

34. For a discussion of the importance of uniqueness in tying arrangements, see *infra* notes 45-53 and accompanying text.

35. See 734 F.2d at 1345. In *International Salt*, the defendants offered to prove that adequate substitutes for the salt machines in question were available, but the Court regarded such proof as irrelevant. See *Northern Pac. Ry. v. United States* 356 U.S. 1, 10 n.8 (1958) (discussing *International Salt*). In *Loew's*, the Court insisted that "the mere presence of competing substitutes for the tying product [feature films] . . . is insufficient to destroy the legal, and indeed the economic, distinctiveness of the copyrighted product." 371 U.S. at 49 (citations omitted).

36. 734 F.2d at 1345.

37. 591 F. Supp. 1350 (E.D. Mich. 1984).

38. This approach was also followed by the district court in *Data General*. See *In re Data General Corp. Antitrust Litig.*, 490 F. Supp. 1089, 1112 (N.D. Cal. 1980), aff'd in part, rev'd in part sub nom. *Digidyne Corp. v. Data General Corp.*, 734 F.2d 1336 (9th Cir. 1984), cert. denied, 53 U.S.L.W. 3910 (U.S. June 25, 1985).

39. 591 F. Supp. at 1359.

not turn on the fact that the films were copyrighted, but rather on the particular attractiveness of the popular tying films, as contrasted with the inferior quality of the tied films.⁴⁰ After analyzing actual market conditions, the court found that the software in question did not have sufficient market power to warrant condemnation of the tie.⁴¹

The courts in *Data General* and *3 P.M.* thus looked to the *Loew's* opinion for guidance about whether economic power should be presumed when the tying product is copyrighted. The *Data General* court read *Loew's* as requiring a rebuttable presumption but severely limited the type of evidence that can be used to rebut that presumption. The *3 P.M.* court read *Loew's* not to require a presumption at all. Yet the relevance of a patent or copyright to a finding of the requisite economic power cannot be determined from the oftentimes vague *Loew's* opinion. Instead, the presumption must be examined in light of more recent developments in tie-in doctrine.

II. RECENT DEVELOPMENTS IN TIE-IN DOCTRINE

According to the Court's own language, a tie can have anticompetitive effects only when a seller has economic power in the relevant market.⁴² It is questionable how seriously the Court adhered to this requirement. Until the most recent two cases, the Court was able to find sufficient economic power in almost any tie-in arrangement,⁴³ even when the power fell short of market dominance and even though it existed only with respect to some of the buyers in the market.⁴⁴ In recent years, however, the Court has demonstrated greater interest in the anticompetitive effects of the tie and has required a showing of actual economic power that would produce such effects.

A. Uniqueness and The Fortner Cases

Rather than engaging in extensive economic analyses of market conditions and of a tying product's market power, the Supreme Court, in considering tie-in arrangements, has utilized shortcuts to determine whether market power exists. The Court has used a uniqueness test, inferring the requisite economic power from the uniqueness of the product. Unique in this context does not simply mean unusual, but is a term of art signifying that "other competitors are in some way pre-

40. See *id.*

41. See *id.* at 1361.

42. See, e.g., *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 104 S. Ct. at 1559, 1561 (1984).

43. One prominent commentator has argued that the line of cases culminating in *Northern Pacific* and *Loew's* "could be read to make actual market power irrelevant." Dam, *Fortner Enterprises v. United States Steel*: "Neither a Borrower, nor a Lender Be," 1969 Sup. Ct. Rev. 1, 26.

44. See *Fortner Enters., Inc. v. United States Steel Corp.*, 394 U.S. 495, 503 (1970) (*Fortner I*).

vented from offering the . . . product themselves."⁴⁵ Thus, uniqueness entails two distinct components: the product is distinctive and unusual, leading some customers to prefer it over any others; and there exists a barrier preventing competitors from producing the product.

The inference of market power from uniqueness was discussed in *Loew's*,⁴⁶ but was further developed in *Fortner Enterprises, Inc. v. United States Steel Corp.*⁴⁷ (*Fortner I*). Its use in *Fortner I* suggested that its application could be almost limitless.

Fortner I involved a challenge to U.S. Steel's financing arrangements. The company was offering one hundred percent financing at below market rates to encourage the purchase of its prefabricated houses. Justice Black, writing for the majority, used uniqueness as a judicial proxy for market power. The attractiveness of the credit terms led to the obvious and unstated conclusion that some customers preferred U.S. Steel's financing arrangement to others. Justice Black noted that in the absence of a legal barrier, such as a patent or copyright, preventing competitors from offering the product, "sufficient economic power" could exist only because of U.S. Steel's "unique economic advantages."⁴⁸ The Court speculated that U.S. Steel's "unique . . . ability to provide 100% financing at cheap rates" could be derived from "economies resulting from the nationwide character of its operations."⁴⁹ The Court thus expanded the scope of the uniqueness test by shifting its focus from attributes of the product itself that prevented competition to advantages the seller had in producing it.⁵⁰

By the time the *Fortner* litigation again reached the Supreme Court some seven years later,⁵¹ a different outlook prevailed;⁵² the reasoning that had produced the result in *Fortner I* was limited. In *Fortner II*, the

45. *Id.* at 505 n.2.

46. *United States v. Loew's, Inc.*, 371 U.S. 38, 45 (1962).

47. 394 U.S. 495 (1969).

48. *Id.* at 505.

49. *Id.* at 505-06. Justice Black also suggested that U.S. Steel may have had a legal advantage because institutional lenders "may have been prohibited from offering 100% financing by state or federal law." *Id.* at 506 (footnote omitted). However, as Professor Dam has pointed out, the fact that institutional lenders promptly began offering 100% financing indicates that those legal impediments were either minor or nonexistent. Dam, *supra* note 43, at 24-25. *Fortner I*'s procedural posture, defendants' motion for summary judgment, explains in part the Court's willingness to find that market power existed and the resultant tenuousness of its justifying rationale.

50. Money, the tying product, cannot be unique. 394 U.S. at 511 (White, J., dissenting). Instead, the Court looked to advantages U.S. Steel might have had in offering the credit. *Id.* at 505-06.

51. See *Fortner Enters., Inc. v. United States Steel Corp.*, 429 U.S. 610 (1977) (*Fortner II*).

52. *Fortner I* was decided by a five to four majority, with Justices White and Harlan writing dissents. By the time *Fortner II* was decided, three of the five justices of the *Fortner I* majority were no longer on the Court. In addition, Justices White and Stewart joined the new majority.

Court abandoned the intimations of *Fortner I* that U.S. Steel might have sufficient economic power because of its size. Instead, the Court focused attention on actual market conditions and on barriers that prevented competitors from offering the same loans, not simply barriers that rendered such an effort economically unwise.⁵³ As a result, the Court found that U.S. Steel did not possess sufficient economic power and the tie was therefore not illegal.

B. Jefferson Parish Hospital District No. 2 v. Hyde

The Supreme Court's most recent encounter with tie-in arrangements was *Jefferson Parish Hospital District No. 2 v. Hyde*.⁵⁴ *Hyde* involved a challenge to an exclusive services contract between a hospital and a group of anesthesiologists. All surgery at the hospital had to be performed using that group of anesthesiologists. The Court analyzed the relevant market in order to determine whether the hospital—the tying product—had sufficient economic power. The Court placed the defendant hospital's share of the market at thirty percent and noted that this hardly represented overwhelming dominance.⁵⁵ Although various market imperfections increased the hospital's market power,⁵⁶ the Court still found that the hospital did not possess the requisite market power to warrant per se condemnation.⁵⁷

53. See 429 U.S. at 621-22.

54. 104 S. Ct. 1551 (1984). Although a unanimous court found that the arrangement in question did not constitute an illegal tie-in, Justice O'Connor submitted a concurrence, joined by Chief Justice Burger and Justices Powell and Rehnquist, in which she called for the abandonment of the per se approach to tie-ins. *Id.* at 1569.

55. The Court almost off-handedly dismissed the hospital's market share as being the same as in *Times-Picayune*, 345 U.S. 594 (1953), in which there was no finding of sufficient economic power. Therefore, the Court found it obvious that such a market share did not demonstrate sufficient economic power. However, the analogy to *Times-Picayune* is somewhat disingenuous. Not only was *Time-Picayune* a five-to-four decision, but much of the language in the opinion concerning requirements for market power was qualified in *Northern Pacific*. There the court stated:

While there is some language in the *Times-Picayune* opinion which speaks of "monopoly power" or "dominance" over the tying product as a necessary precondition for application of the rule of per se unreasonableness to tying arrangements, we do not construe this general language as requiring anything more than sufficient economic power to impose an appreciable restraint on free competition in the tied product . . .

356 U.S. 1, 11 (1958). This view is given further credence by the fact that the opinions in both *Northern Pacific* and *Fortner I*, two cases in which the Court evidenced a great willingness to find economic power, were written by Justice Black, one of the four dissenters in *Times-Picayune*.

56. The market imperfections included the prevalence of third party payment for health care costs, which rendered the market price insensitive, and the lack of adequate information, which made quality evaluations difficult. 104 S.Ct. at 1556. Additionally, the Court noted that reasons of "family convenience tend[] to magnify the importance of location." *Id.* The hospital's position as the only public hospital of the East Bank Jefferson Parish acted to increase its desirability to residents of the parish.

57. It is interesting that no mention was made of the fact that the hospital had no

Besides arguing that an analysis of the market conditions demonstrated sufficient economic power, the plaintiff in *Hyde* also argued that such power could be inferred from the uniqueness of the hospital.⁵⁸ Evidence demonstrated that many consumers prefer public, nonprofit hospitals over private, for-profit hospitals. This preference apparently derives from a popular distaste for or distrust of the notion of health care for profit. As the only nonprofit hospital in the relevant market, the hospital was arguably distinctive and unusual. In addition, the regulatory hurdles⁵⁹ standing in the way of constructing a hospital seem to satisfy the barrier requirement of the uniqueness test. The Court, however, while making no mention of this argument, implicitly rejected it by undertaking an analysis of the relevant market rather than using the uniqueness test.

Fortner II and *Hyde* indicate that the Court is considering more seriously its requirement that the tying product have sufficient market power. The Court has moved from the ready willingness to condemn tying arrangements that it exhibited in *Loew's* and *Fortner I* to a less hostile position. This trend in antitrust doctrine suggests that an approach that presumes market power from surrounding circumstances is questionable.

III. PROBLEMS WITH THE PRESUMPTION

A. No Basis in Economic Theory

Tie-ins are only condemned when "power in the market for the tying product is used to create *additional* market power in the market for the *tied* product."⁶⁰ The principle is that economic power in the tying product can be used to force buyers into purchases they would not have made absent the tie.⁶¹ Per se condemnation of a tie-in arrangement,

apparent economic motives for utilizing the tie. The harm from a tying arrangement is supposed to be the extension of some of the monopoly profits of the tying product to the tied product. Even if this were the case in *Hyde*, the hospital would have received none of the monopoly profits that were extended to the tied product. Indeed, if the hospital actually had economic power and thus was able to derive monopoly profits, the tying arrangement was positively injurious to them as it would have entailed a transfer of some of the hospital's monopoly profits to the group of anesthesiologists. Since the hospital had absolutely no economic incentive to engage in the tying arrangement, the most likely conclusion is that the hospital was acting on what it perceived to be the best interests of the patient.

58. See Brief for Respondent at 41, *Hyde*.

59. There was no evidence that the existing hospitals were not adequately meeting the needs of the residents of Jefferson Parish. The construction of another public hospital in the area was unlikely. See La. Rev. Stat. Ann. § 40:2017.4 (West 1977).

60. *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 104 S. Ct. 1551, 1571 (1984) (O'Connor, J., concurring) (emphasis in original, footnote omitted).

61. Although it may seem counterintuitive, antitrust law does not condemn arrangements that force a buyer to purchase a product he would not otherwise have bought in the tied market. For example, if a buyer is forced to buy *Y* (tied product) in order to purchase *X* (tying product), but *Y* is a product for which the buyer has no use,

without an inquiry into actual market conditions, is only appropriate if such anticompetitive forcing is likely.⁶² Therefore, the presumption of economic power that attaches to copyrighted and patented products can be justified only if a tie-in arrangement involving such products is likely to result in anticompetitive forcing.⁶³ Such a conclusion, however, cannot be drawn from the simple fact that a product is patented or copyrighted.

The mere existence of a patent or copyright does not create a demand for a product. Indeed, the majority of all patents and copyrights confer little or no monopoly power.⁶⁴ A cursory examination of the market structure for patented or copyrighted goods bears this out. Since each seller's product is differentiated, buyers are matched with sellers on the basis of the buyer's preference. The market is thus not perfectly competitive, since a seller may raise prices without losing every buyer to another seller. The buyer may continue to purchase the good because his preference for it outweighs the price disincentive.⁶⁵ Even if a seller is exacting supernormal profits, it is not necessarily the patent or copyright which allows him to do so. The potential for supernormal profits exists because of barriers to entry, divergent costs, or strong consumer preferences for one of the products.⁶⁶ Central to the issue of whether a producer can exact these profits is the existence of adequate substitutes that can be produced at roughly the same cost. If such substitutes exist, supernormal profits are impossible to sustain.⁶⁷ However, the existence of a patent or copyright provides little, if any, evidence of supernormal profits, barriers to entry, consumer preferences, or absence of adequate substitutes. It thus does not dispose of

no antitrust violation has occurred. Such forcing is not anticompetitive because no portion of the market for *Y* has been foreclosed. See *id.* at 1560.

62. See *id.*

63. The Court has never considered whether the differences in patent and copyright law warrant different treatment. The Court began with the observation that one of the policies of patent law is to reward uniqueness, thereby providing at least a superficial plausibility to a finding of economic power based on uniqueness. Although a product must be novel in order to be patentable, a product has only to be the original work of an author to be protected by the copyright laws.

In addition, the difference between the legal rights accorded by a patent and a copyright might require a different result. A patent grants a monopoly in the sense of a right to exclude others even though they may have subsequently discovered the product. A copyright only protects against copying. See *Dam*, *supra* note 43, at 23.

64. Panel Discussion: The Value of Patents and Other Legally Protected Commercial Rights, 53 *Antitrust L.J.* 535, 547 (1985) (F. Scherer speaking) [hereinafter Panel Discussion].

65. See E. Chamberlin, *The Theory of Monopolistic Competition* 69 (1956).

66. See *id.* at 82.

67. For a more thorough analysis of this type of argument, see Note, *The Presumption of Market Power in Sales of Legally Differentiated Tying Products*, 56 *Tex. L. Rev.* 1305, 1307-10 (1978).

the question whether a product has market power.⁶⁸

One might concede that this market analysis is accurate and still argue that the presumption should be retained. The argument is that tying arrangements involving patented and copyrighted products that are accepted by customers, and eventually end up as the subject of an antitrust action, usually involve that small minority of patents and copyrights that do confer a sufficient degree of market power. However, two considerations render this argument implausible. First, it is not clear what the existence of the patent or copyright has to do with the success of the tie-in. The fact that a tie-in is accepted by consumers has been implicitly rejected by the Supreme Court as conclusive evidence of sufficient economic power.⁶⁹ There is little reason to argue that successful tie-ins involving patents or copyrights are any different. Second, since the presumption makes success in court much less difficult, the victor's treble damages provide incentive for the bringing of nuisance suits in many instances in which the patented or copyrighted product has no market power.⁷⁰

The economic arguments in support of the presumption appear to be tenuous.⁷¹ The existence of a patent or copyright is recognized by

68. See Lavey, Patents, Copyrights, and Trademarks as Sources of Market Power in Antitrust Cases, 27 Antitrust Bull. 433, 437 (1982).

69. The fact that a tying arrangement is accepted by consumers has little to do with whether the tying product is patented or copyrighted. The Supreme Court suggested in *Fortner I* that the success of a tie-in could be considered as evidence of the tying product's market power. However, in *Fortner II* and *Hyde*, the Court was faced with tying arrangements accepted by consumers, but in neither case did the Court find sufficient market power. Thus, the Court implicitly rejected the suggestion of *Fortner I*.

70. See Panel Discussion, *supra* note 64, at 547 (F. Scherer speaking).

71. One commentator has admitted that "[p]atents or copyrights . . . do not always afford an accurate basis from which to infer a significant anticompetitive effect. In effect, economic power is [conclusively] presumed from a patent or a copyright primarily to safeguard against the abuse of a legally sanctioned monopoly." 2 E. Kintner, *Federal Antitrust Law* 244 (1980) (footnotes omitted). Such a view is at the core of the decisions in *International Salt* and *Paramount Pictures*. See *supra* notes 13 & 18 and accompanying text. With respect to copyright, the Court stated in *Paramount Pictures*:

The copyright law . . . makes reward to the owner a secondary consideration "The sole interest of the United States and the primary object in conferring the monopoly lie in the general benefits derived by the public from the labor of authors." It is said that reward to the author or artist serves to induce release to the public of the products of his creative genius.

334 U.S. 131, 158 (1948) (quoting *Fox Film Corp. v. Doyal*, 286 U.S. 123, 127 (1932)). According to this view, patents and copyrights are exceptions to competitive policy and must be construed as narrowly as possible. A better view of the patent and copyright laws is that they protect "a species of property whose use and disposition are no more immune from scrutiny under antitrust law . . . than other forms of property." Turner, *Basic Principles in Formulating Antitrust and Misuse Constraints on the Exploitation of Intellectual Property Rights*, 53 Antitrust L.J. 485 (1985). Thus, policies of patent and copyright law do not mandate either particularly solicitous or particularly harsh treatment of tying arrangements connected with patented or copyrighted products.

commentators as a poor predictor of market power.⁷² Without such economic power, the possibility of anticompetitive forcing is unlikely. The presumption is dangerously close to "an antitrust policy divorced from market considerations . . . [and therefore] lack[ing] any objective benchmarks."⁷³

B. *The Presumption and the Uniqueness Test*

Although the presumption is not justified on economic grounds, it was, at least at its inception, in line with the Court's extremely hostile attitude towards tie-ins.⁷⁴ The Supreme Court claimed to base its condemnation of various tie-in arrangements on the use of the market power of the tying product as leverage to acquire market power for another product. Nevertheless, the standards by which the existence of market power was measured were such that market power was almost always found.⁷⁵ The Court's increased unwillingness to find that market power exists, however, renders the presumption inconsistent with the Court's more recent approach to tie-ins.

In *Fortner I*, the Court explained how the uniqueness of the product enabled an inference of market power to be drawn, pointing to *International Salt* and *Loew's* as instances in which market power had been inferred from the uniqueness of the product.⁷⁶ Although it had appeared that the Court viewed tie-ins involving patents or copyrights as a special category,⁷⁷ such was no longer the case. The Supreme Court in *Fortner II* seemed to say that such tie-ins should be judged by the standards of uniqueness applied to other tie-in arrangements with the patent or copyright serving as a "legal barrier" to competition.⁷⁸

The *Fortner I* Court insisted that its formulation of a uniqueness test was a continuation of and not a departure from prior doctrine. However, application of the uniqueness test to tie-ins of copyrighted and patented products appears to conflict with earlier treatments of such arrangements. Under the uniqueness test, a court must be willing to examine the relevant market, including possible substitutes for the

72. See, e.g., Turner, *supra* note 71, at 486.

73. *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36, 53 n.21 (1977).

74. See, e.g., *Standard Oil Co. v. United States*, 337 U.S. 293, 305-06 (1949) ("Tying arrangements serve hardly any purpose beyond the suppression of competition.").

75. See *supra* note 43 and accompanying text.

76. See *Fortner I*, 394 U.S. at 505 & n.2. This footnote from *Fortner I* was quoted in *Fortner II*, 429 U.S. at 621. It is unclear why *International Salt* was cited since that case never focused on the market power of the tying products, the salt processing machines. See *supra* text accompanying note 14.

77. See *Loew's*, 371 U.S. at 45-46.

78. But cf. 2 P. Areeda & D. Turner, *Antitrust Law* 300 (1978) ("[P]atents . . . are not insurmountable entry barriers. Unlike direct entry controls, which block entry even though the would-be entrant can match or beat the costs of [the] existing firm, patents offer no protection against the entrant who develops an offsetting or comparable but non-infringing innovation.").

tying product. Indeed, the test makes little sense without such an examination, as a product can only be distinctive or unusual in comparison with other products. Nevertheless, according to *International Salt*, inquiry into possible substitutes for patented and copyrighted products was foreclosed. The *International Salt* Court deemed it irrelevant that other manufacturers produced similar salt processing machinery.⁷⁹ This foreclosure may have some intuitive appeal in the factual context of a case such as *Loew's*. There is only one "Gone With the Wind" and, at least arguably, talk of possible substitutes is pointless. In the more usual case, adequate substitutes do exist.

It is also not enough to insist that "[s]ince one of the objectives of the patent laws is to reward uniqueness, . . . the existence of a valid patent on the tying product, without more, establishes a distinctiveness sufficient to conclude that any tying arrangement involving the patented product would have anticompetitive consequences."⁸⁰ A product may be unique in the legal sense in that it cannot be copied or that others can be prevented from infringing on the patent, but uniqueness in antitrust doctrine means that a product is distinctive enough to be especially attractive to consumers.⁸¹ Market power is a result of this strong preference. That a product may be novel enough to qualify for a patent is no guarantee that it will be attractive to consumers.⁸² Indeed, many patents are no more than relatively minor improvements of other patents. As for copyrights, there is not even a requirement of novelty as there is with patents; such commercial sundries as codebooks, door knockers, fishbowls, and ashtrays have been copyrighted.⁸³ Holders of these copyrights certainly ought not be deemed, without more, to have significant economic power in the copyrighted product.

C. *The Viability of the Presumption After Hyde*

In *Hyde*, as in *Fortner II*, the Court engaged in relatively extensive analysis of the tying product's market power. The *Hyde* court recognized that the conditions and imperfections of the market gave the hospital market power over its product.⁸⁴ The Court, however, deemed this to be market power only in "some abstract sense," a power that

79. See *supra* note 35.

80. *Loew's*, 371 U.S. at 46. The Court insisted that this applied to copyrights as well. *Id.*

81. *Id.* at 45.

82. Of course, it would be internally consistent to claim that the patented product is so distinctive that the relevant market should be defined as including only the product in question. Such an argument, however, ignores economic realities. The mere fact that a product was novel enough to be patentable is not determinative of whether it has market power. See *Hyde*, 104 S. Ct. at 1572 n.7 (O'Connor, J., concurring).

83. See *Mazer v. Stein*, 347 U.S. 201, 219-21 (1954) (separate opinion of Douglas, J.).

84. See *supra* note 56 and accompanying text.

was not enough to justify condemnation of the tie.⁸⁵ Just how the Court was able to distinguish "abstract" power from the kind that would justify condemnation, it did not say. The change in the Court's attitude is striking. In *Fortner II*, the issue was "whether the seller has the power . . . to raise prices or to require purchasers to accept burdensome terms that could not be exacted in a completely competitive market."⁸⁶ It is difficult, if not impossible, to distinguish this definition of market power from "abstract" market power. The actual decision in *Fortner II* indicates that, regardless of the quoted language, the Court had already moved away from the ready willingness to find sufficient market power that it had earlier exhibited. The language in *Hyde* makes this movement clear. It is apparent that the Court now demands a clear showing of substantial economic power in order to justify per se condemnation. If a copyright or patent were an inaccurate predictor of the existence of the requisite market power before *Hyde*,⁸⁷ the changes in the Court's view of what constitutes sufficient market power makes either even less accurate after *Hyde*.

Since the patent and copyright presumption is based on the uniqueness test,⁸⁸ any curtailment of the use of the uniqueness test as a judicial shortcut to a finding of economic power affects the use of the presumption as well. *Hyde* suggests that the Court's willingness to infer economic power based on the uniqueness of the product is less than it once was. In *Hyde*, the hospital market was recognized as a price insensitive market in which a lack of adequate information rendered consumers unable to evaluate the quality of medical care provided by the competing hospitals. In such a market, the location of a hospital and its status as public and nonprofit or private are of great importance.⁸⁹ The hospital's position as the only nonprofit hospital in the relevant market area would seem to lead to the conclusion that for those customers in the area who prefer nonprofit hospitals to private ones, the hospital was uniquely desirable. However, the Court, by undertaking an analysis of the actual economic conditions in the market, implicitly rejected any claim that the hospital was unique. This suggests that an inference of market power based on uniqueness, which avoids more extensive economic analysis, will be used less frequently in the future.⁹⁰

The Court seems increasingly unwilling to find the economic

85. See *Hyde*, 104 S. Ct. at 1566.

86. 429 U.S. at 620.

87. See *supra* note 31 and accompanying text.

88. See *supra* notes 76-78 and accompanying text.

89. See *supra* notes 55-56.

90. The Court in *NCAA v. Board of Regents*, 104 S. Ct. 2948 (1984), found that college football had sufficient power based on the uniqueness of the product. The opinion makes clear that the uniqueness test being applied in *NCAA* is identical to the one used for tying arrangements. A finding that college football is unique after considering all possible substitutes is very different from a finding that a patented or copyrighted product is unique even though there exist adequate substitutes. See *Digidyne Corp. v.*

power that is a prerequisite to finding tying arrangements per se illegal. This is suggested by the Court's greater willingness to engage in more detailed analysis of the actual prevailing market conditions.⁹¹ The Court's reluctance to infer economic power from uniqueness is consistent with this approach. Since the patent and copyright presumption is an application of the uniqueness test, any tightening of the standards by which uniqueness is determined further reduces the appropriateness of the presumption.

D. Procompetitive Effects of Tying Arrangements

Even if the presumption has few economic justifications⁹² and is no longer consistent with antitrust doctrine, one might still question whether the damage caused by the presumption is so great, given that tie-ins are believed to have such pernicious effects that they are subject to per se condemnation. One must keep in mind, however, that tie-ins are only condemned under the per se test if such market power exists that there is a probability of anticompetitive compulsion. Implicit in the test is the recognition that some tie-ins have neutral or even procompetitive effects. Justice White made this clear in his dissent in *Fortner I*. He noted that tie-ins

may facilitate new entry into fields where established sellers have wedded their customers to them by ties of habit and custom They may permit clandestine price cutting in products which otherwise would have no price competition at all because of fear of retaliation from the few other producers dealing in the market. They may protect the reputation of the tying product if failure to use the tied product in conjunction with it may cause it to malfunction And, if the tied and tying products are functionally related, they may reduce costs through economies of joint production and distribution.⁹³

In addition, the Court itself has explicitly recognized that certain nascent industries may require the use of tying contracts for maintenance

Data General Corp., 734 F.2d 1336, 1345 (1984), cert. denied, 53 U.S.L.W. 3910 (U.S. June 25, 1985).

Perhaps the most curious aspect of *NCAA*, at least for the purposes of this Note, is contained in a footnote. In his discussion about the inference of market power from the uniqueness of a product, Justice Stevens cites *Hyde* and *Fortner I* for support. However, he also cites the footnote in Justice O'Connor's concurrence in *Hyde*, that insisted that there is no presumption of market power, either conclusive or rebuttable, if the product is patented or copyrighted. 104 S. Ct. at 2966 n.45. It is difficult to understand why Justice Stevens cited O'Connor's footnote, especially since the footnote was probably written by Justice O'Connor in response to his recitation of the existence of the presumption in the *Hyde* opinion.

91. Compare *Hyde*, 104 S. Ct. at 1566-67 (specifically analyzing hospital market), with *International Salt*, 332 U.S. 392 (1947) (failing to consider impact of possible replacements for petitioner's salt processing machines).

92. See *supra* notes 64-68 and accompanying text.

93. 394 U.S. 495, 514 n.9 (1969) (citations omitted).

agreements to avoid breakdowns which could result at the hands of inadequately trained personnel.⁹⁴

Development and marketing problems in the computer software industry have demonstrated further beneficial uses of tying arrangements. There is a serious need for adequate protection of computer software in order to encourage the investment necessary to stimulate the design and production of innovative software. Congress moved to solve this problem by extending copyright protection to computer software in 1980.⁹⁵ Adequate protection of copyrighted software may not be possible if the use of the copyrighted software cannot be metered.⁹⁶ Tying arrangements are recognized as a cost-effective means by which a producer can meter use of his product. The issue is whether the social resource costs of designing alternative means of metering use are greater than the loss to buyers from the imposition of tie-ins. The resolution of such an issue is difficult.⁹⁷ Arguably, it requires the abolition of the per se rule against tying arrangements,⁹⁸ but at a minimum it requires a more discriminating treatment of tie-ins involving copyrighted computer software than the presumption presently allows.

CONCLUSION

Patents and copyrights are sometimes quite valuable and give to their owner a degree of market power. More often than not, however, a patent or copyright provides little, if any, market power. Thus, the presumption of sufficient market power leading to a per se condemnation of a tying arrangement involving such products is unwarranted. Moreover, the Supreme Court's more recent tying arrangement decisions have evidenced an increased demand for a showing of actual market power than was required in earlier cases. The presumption of market power for patented or copyrighted goods is inconsistent with this approach. Tying arrangements involving patented or copyrighted products should be treated like other tying arrangements and should only be condemned upon a showing of actual economic power.

William Montgomery

94. See *United States v. Jerrold Elec. Corp.*, 187 F. Supp. 545 (E.D. Pa. 1960), *aff'd*, 365 U.S. 567 (1961) (*per curiam*) (maintenance agreement as part of sale of television antenna equipment).

95. See 17 U.S.C. § 101 (1982).

96. Panel Discussion, *supra* note 64, at 551 (F. Scherer speaking).

97. See *Id.*

98. If the presumption of market power were abolished and the tying arrangement was not found to have sufficient economic power to warrant per se condemnation, a court would be able to consider the matter under the rule of reason.

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DEPARTMENT OF ECONOMICS

October 31, 1987

(215) 328-8125

Senators Patrick Leahy and Howard Metzenbaum
Committee on the Judiciary
United States Senate
Washington, DC 20510

Dear Senators Metzenbaum and Leahy:

This is in reply to your letter of October 21 asking for comments on S. 438, the Intellectual Property Antitrust Protection Act of 1987.

The bill's main substantive provisions would subject patent and other intellectual property rights licensing agreements to rule of reason adjudication under the antitrust laws and allow only single damages, including interest and costs, in the event of violation.

Frankly, I find the bill puzzling and overly broad. In his introduction of the bill February 3, 1987, Senator Leahy stated that the intent is to promote competition in the international market of ideas -- clearly a commendable goal. He goes on to suggest that "agreements to convey intellectual property rights would no longer be deemed illegal 'per se' under the antitrust laws." This seems perplexing, because to the best of my knowledge, patent licensing per se has never been considered illegal. Indeed, I have seen decisions in which it was seen as positively beneficial per se. It is only the inclusion of certain restrictions in licenses that has been ruled illegal, especially when the restrictions were agreed to bilaterally or multilaterally rather than being imposed unilaterally by the holder of a valid patent. I am sure legal scholars will clarify the bounds of the established case law better than I can as an economist concerned with questions of technological innovation.

The implication one has to draw from the bill is that it is intended to relax legal bars against restrictive agreements in intellectual property licenses, but it is unclear whether the relaxation is across-the-board or selective. Some restrictions, such as a requirement that licensees not disclose licensed trade secrets to third parties or to grant back licenses on new technology resulting from the immediate license, are unlikely to cause economic performance problems. Other restrictions, such as a unilateral tying clause requiring licensees to buy certain goods or services in conjunction with exercise of the license, have traditionally been considered per se illegal, but might under narrowly-defined circumstances have redeeming value. Skipping to the other extreme, joint agreements to respect territorial or product line spheres of influence or to fix prices are apt seldom to yield economic benefits in excess of the costs they impose in the form of reduced competition and blunted incentives to leap ahead technologically. Restrictions of the last type were rampant during the 1920s and 1930s. The Committee should not press forward in this area without reviewing carefully the evidence from that period presented in Floyd L. Vaughan, The United States Patent System, and George Stocking and M. W. Watkins, Cartels in Action.

I believe that cases can in fact arise in which allowing intellectual property license restrictions, including some that have traditionally been frowned upon by antitrust, might

provide additional incentive for U.S. firms to invest in new technology. The granting of patent and similar rights is intrinsically a tradeoff. On one hand, some protection from competition in the wake of successful innovation has a very desirable incentive effect. On the other hand, too much protection harms consumers unnecessarily and, by insulating the patent holders from new technological challenges, may actually retard the rate of technical progress. Restrictions that reduce a patent holder's fear of being leap-frogged by superior new products or processes can have an especially stultifying effect.

It should be recognized too that strong patent protection or similar intellectual property protection is in many instances unnecessary to the motivation of research, development, and the introduction of new technology. My research on such questions (in the 1959 book, Patents and the Corporation), the 1973 book on British firms by C. T. Taylor and Z. A. Silberston, and Edwin Mansfield's more recent research all show that in more cases than not, large, well-established firms would innovate without any patent protection at all. On the other hand, patent protection may be necessary to innovation by small firms, larger firms striking out in completely new directions, and firms making innovations (such as pharmaceuticals) in which very large outlays must be incurred to bring a new product on the market, but which can be imitated by other firms at a small fraction of the first mover's research, development, and testing costs.

In principle, rule of reason treatment of antitrust challenges to intellectual property license restrictions could take into account such subtleties. And in principle, I favor such a rule of reason approach. But as a matter of actual practice, the Federal courts have great difficulty dealing with complex rule of reason determinations. Under a broadly sweeping rule of reason, litigations would be very expensive, and judicial error would occur in a considerable fraction of the cases litigated. If only single damages were allowed in every instance, practices that have little redeeming merit and do substantial damage to consumers might not be challenged. On the other hand, it must be recognized that trebling of damages sometimes creates incentives for parties to trump up what ought to be straightforward patent validity challenges or contractual disagreements into suits with antitrust claims.

The solution to these dilemmas, it seems to me, is for the Committee to be more specific in the kinds of license restrictions it wishes to see treated under a rule of reason, or alternatively, to specify those that would continue to be subject to a per se rule and/or trebling of damages. There is a continuum of possible cases, and I will not attempt to tell where the line ought to be drawn. Second, the Committee should be more specific as to how the burden of proof will be divided. For those license restrictions that with any appreciable likelihood can injure consumers, close off innovative new entry beyond the specific bounds of the licensed technology, and/or otherwise blunt incentives for independent innovation, I would urge that a heavy burden of proof be placed upon the restricting party pleading a rule of reason defense. The presumption of illegality could then be rebutted by bearing that burden of proof.

I recognize that these recommendations are not very specific. But the question is far too difficult and important to propose policies without a study more extensive than any of which I am presently capable.

Sincerely yours,

F. M. Scherer

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Lyle D. Rice
Senior Vice President
Government Affairs

December 16, 1987

The Honorable Patrick J. Leahy
United States Senate
433 Russell Senate Office Building
Washington, D.C. 20510-4502

Dear Senator Leahy:

Current U.S. law significantly restricts the competitiveness of American companies in the computer and other high technology industries by subjecting many intellectual property licensing arrangements to a per se antitrust analysis without any consideration of whether a particular licensing arrangement is in fact anticompetitive. This problem is of particular concern to the computer industry. In some instances, licensing agreements related to the marketing of technologically related products have been found to constitute unlawful "tying" arrangements under the antitrust laws. The application of such traditional per se antitrust analysis to the commercialization of new technologies is both inappropriate and unnecessary.

Control Data appreciates your efforts as sponsor of the Intellectual Property Antitrust Protection Act of 1987 (S. 438, H.R. 557) which would modify the application of the antitrust laws so as to encourage the licensing and other uses of certain intellectual property. This legislation simply requires that licensing agreements that convey patent, copyright or trade secret rights be evaluated for antitrust purposes under the rule of reason, not a per se rule. Thus, agreements that create an anticompetitive environment would still be illegal, but procompetitive licensing agreements would be allowed.

In our own operations, we have occasionally decided not to enter into intellectual property licensing agreements out of concern that provisions designed to protect the value of our property might be viewed as per se unlawful. Similarly, in negotiating the acquisition of license rights, we have adopted a cautious approach and have some times consciously avoided acquiring marketing rights which would have enabled us to enter a market. Such practices limit both our flexibility in developing and commercializing new technologies, and our ability to recover major investments in research and development. Finally, as a supplier of systems of interconnected equipment and proprietary software and related support and training services, we are concerned that the

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current antitrust laws unnecessarily restrict our use of licensing agreements which can help to assure that our products and systems are used appropriately. The net result is less competition, not more -- and our country and its consumers suffer the consequences.

In summary, we believe that the traditional *per se* rules of antitrust law should not blindly apply to licensing agreements that convey rights to patents, copyrights and trade secrets. Such licensing arrangements are important to the development and commercialization of new technologies and to maintaining America's technological leadership and global competitiveness. The goals of the antitrust laws will be adequately maintained by subjecting intellectual property licensing agreements to the rule of reason to determine in the particular case whether an agreement has, on balance, an anticompetitive or procompetitive effect.

The legislation, S.438 and H.R. 557, provides an opportunity for strengthening the American economy. When this legislation is approved, antitrust and intellectual property laws will work together to increase incentives for U.S. industry to innovate and to turn these innovations into competitive products. I very much appreciate your efforts as sponsor of this important legislation and I urge your continued support.

Sincerely,

Lns

Lois D. Rice

LDR/mlb